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A Comprehensive Analysis of the Accounting Environment and Procedures Through a Series of Case Studies

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A Comprehensive Analysis of the Accounting Environment and Procedures Through a Series of Case Studies

By

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A thesis submitted to the faculty of The University of Mississippi in partial fulfillment of the requirements of the Sally McDonnell Barksdale Honors College.

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ABSTRACT

Ryan Davis McCarty: A Comprehensive Analysis of the Accounting Environment and Procedures Through a Series of Case Studies

(Under the direction of Dr. Victoria Dickinson)

The following thesis is a culmination of twelve case studies completed throughout the academic year of 2018-2019 under the direction of Dr. Victoria Dickinson, as a requirement of the Sally McDonnell Barksdale Honors College and completion of the ACCY 420 course. Each case study is independent of the next, and is an in-depth response to questions and theories that are found outside of this document. Each analysis is accomplished by myself alone and through the studies of Financial, Managerial, and Cost accounting courses in my career at the University of Mississippi. The thesis is intended to analyze accounting procedures and the current general accounting environment and topics. Accountants' play a crucial role in the global economy, establishing trust and assurance through analytical and conceptual research and procedures. This thesis below illuminates several accounting problems, procedures, and questions posed by entities such as WorldCom, Starbucks, BP, and others.

Besides the technical cases, other such as Case Study 1 and Case Study 5 are personal accounts of the accounting space and its impact on daily life and the economy. Rapid change in technology, corporations, and industries equate to an equally drastic adaption of public accountants. Computer software importance is quickly increasing and becoming more necessary as a basic skill for accountants.

Overall, this thesis is intended to educate the reader on the ever-changing accounting world and how accountants are solving problems as quickly as the appear. This thesis, completed during coursework for ACCY 420, created multiple skills necessary for an accountant in either Audit, Tax, or Management Consulting. Research, critical thinking, public speaking, and professional writing/communication are just a few skills that were improved and acquired through the creation of this thesis.

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Case Study 1: Microsoft Power BI

Introduction

I was not familiar with Microsoft's Power BI technology previous to this case study; However, throughout schooling, I have become experienced with Microsoft's other "office" applications such as PowerPoint, Excel, and Word. After extensive research, Power BI has also proven to be a cost-efficient, time-saving, and customer retaining software for a multitude of accounting applications. There are general application benefits such as saving time during audits tax client interactions. Throughout this study, each of the points listed above are addressed by engaging real and potential accounting scenarios in order to explain its usefulness. This case study is intended to prove the real benefits of Microsoft's Power BI technology within the dynamic accounting data-analytics space.

Purpose and usefulness in making business decisions

Microsoft Power BI is a business analytics tool that helps professionals convert masses of complex and raw data from a multitude of external or cloud-based sources into easily understandable graphs, models, and other relevant visuals. Power BI's data connections makes real time data, works in progress, and finished financial models/statements easily accessible to internal decision makers and external parties with any sort of stakeholder position. This software speeds up the process modeling, decision making, and publishing so users can be more efficient and profitable within its operations. It allows information to be published and implanted into websites and apps, which are accessible from virtually anywhere. Collaboration is made more efficient on a dashboard platform where teams can work together on one project, or multiple projects simultaneously whether or not members are in the same building separated overseas.

Data can be accessed from countless external manufacturing, marketing, or relevant business sources and imported and configured so that all needed information is in a centralized location. Microsoft Power BI can reduce time spent preparing presentable data and use it in beneficial ways similar to the configuration and formulation tactics found in similar tools such as Microsoft Excel. The language of data sifting and sorting is comfortably similar to Excel in order for users to have smooth transition and reduce learning curves between the different tools.

Tool usefulness in business settings

Audit applications:

Verifiability is a focus piece for auditors in their practices. When using Microsoft Power BI, one can view items from financial spreadsheets such as Excel and other items from sources such as Salesforce, or any other Customer Relationship Management (CRM) software. By doing this, auditors can easily asses accounts like receivable or sales transactions from sources such as Excel, or anything similar, and verify the customers existence and history of transactions through the other compatible software, Salesforce. This gives another level of security and makes it harder for an enterprise to fraudulently record sales or any other revenue generating transaction. Microsoft Power BI saves time in multiple ways and we know saving time can save money. When a firm sends auditors away from the office, there are many travel and hospitality expenses incurred. Decreasing time spent away from the office, one can reduce the amount money spent. Also, individuals do not need to transfer from one software to another to learn how to sift through series of useless data in order to find the few pieces they need. Power BI's centralization eases a burden for auditors by giving them one program to work with and not have a reason to leave that platform. Learning curves are reduced by keeping the tools within the software simple and similar to the beloved Microsoft Excel, which increases efficiency and user interface (UI) satisfaction. The transfer of simple and similar functions and formulas used to clean data saves auditors time when cleaning data and transferring raw information into relevant information. The abundance of visually adept functions allows for an easier understanding and line of communication between auditors and the entity being audited, hopefully increasing natural goodwill of the accounting firm and future client retention.

Depreciation can become a more accurate number for auditors to equate when using power BI. For example, if a manufacturing entity records its depreciation on its machinery based on hourly usage, and employees use an automated time clock system that verifies their hours of usage on machinery, auditors can verify exactly which employee spent an exact amount of time using a certain machine. This exact calculation of machine usage enables auditors to find a more accurate value for machine depreciation, spread amongst individual machines or just one. Fair valuation of assets and liabilities can be recorded and audited more accurately whenever a firm can compare real time market conditions of certain commodities to the accounts listed on an entities balance sheet. Compared to historical costs which do not change, fair value is a fluid value that can change dramatically over time. It is very important for corporations that use fair value accounting to be accurate as possible because the false recording of balance sheet information can mislead a third parties' financial decision making, rupture GAAP's fundamental qualities of faithful representation, and decline overall transparency and reliability of a corporation.

Tax applications:

Accountants who spend time solving taxation solutions can have a very diverse client base. Clients can range from international publicly traded corporations to simply-operated single proprietorships. A firm's clients could have forty accounting employees or considered 'mom & pop" having no accounting background at all. When serving clients, intentions are to solve their issues effectively and with the lowest amount of costs. Tax consultants need to be informed on the complex data of tax rates, laws, and other variables. These variables must turn it into information the client can understand and agree on. Microsoft Power BI allows for accountants to create simple graphs and models for clients who may not understand an array of ambiguous numbers on a spreadsheet. At the same time, the software allows for accountants to quickly share the same models with a corporation's numerous accounting employees. With the transparency and knowledge transfer from professional to client, or professional to professional, Power BI's attributes allow for higher profit and client satisfaction/retention. In a situation where corporations generate revenue in multiple states or countries at the same time, local tax laws in the respective locations can alter accounting procedures. Power Bi assists with the compilation and analyzation of different tax regulations and custom changes that occur in consequence to external political and economic action. When a corporation is in the beginning stages of formation, or planning the construction of a new location, it is wise to understand and strategically place a higher revenue generating location in a location with the lowest corporate taxes. It may be wise to place a head office with large number of employees in an area with lower household/personal income taxes to satisfy employees. Areas with low or no sales taxes can be ideal for manufacturing plants where raw materials are commonly purchased. All of these scenarios need to be analyzed in depth with up-to-date tax regulations. Power BI can assist this scenario by pulling all relevant tax information to a dashboard along with other strategic information, such as interest and capital debt information, to make decisions about the future of a possible new enterprise.

Letter of recommendation to firm

After researching Microsoft's Power BI software, I can confidentially recommend that we acquire it for future accounting procedures inhouse and in our dealings with clients. This tool requires low costs, will save us time, and its ease to use will satisfy our customers. Hiring new accountants can be an exciting process; However, it can take a lot of time and money to train new accountants on how to use our accounting tools and procedures. With Power BI, learning curves are minimalized due to its familiar Microsoft setup. Most of our new accountants are proficient with many of Microsoft's tools such as Excel, and Power BI keeps those skillsets constants through the transference of tools. By saving training time, we save money by cutting training costs and instructor costs and can dedicate the time saved to revenue generating opportunities in the field.

With all of this being said, whenever our clients save money, they become happier and our relationship becomes stronger. With maximum customer retention we can expect our revenues to occur routinely if not increasingly by the spread of our success. I believe that with efficient use of this tool we can increase our profits and make all of our processes easier and both satisfying to ourselves and anyone we interact with. To continue our success in the market, we must keep up with the changing times and technological advances. Incorporating business information and analytic software is one of the largest ways we can compete with our competitors and set a higher standard for accounting services. Currently, Power BI sells for around ten dollars a month per user, but expected to become free in the near future. Even though costs are minimal, it may be in our interests to wait until the costs drop before purchasing Power BI and prepare for our upcoming transition. I believe our return on investment in this product will be extraordinary due to its effectiveness and virtually nonexistent costs.

Case Study 2: Rocky Mountain Chocolate Factory

Introduction

Before this case study I had some basic knowledge on excel and its functions (SUM, SUMIF, etc.) from previous work experiences. However, I have never had any experience linking accounting procedures with excel in forming income statements, balance sheets or ledgers. I really enjoyed learning even more functions and usefulness qualities of excel because I know I will be using this software for a long time unless it is replaced by a better one. This case is supposed to communicate how excel saves firms time and money with its convenience to use.

A

I expect to see a lot of raw materials and inventories due to the high volume of materials needed each day. I expect to see a wage payable because a lot of chocolate and specialty confectionary goods are made by a skilled laborers hand. There should not be an exceptional amount of long-term debt coming from fixed assets, because there is not a lot of heavy machinery involved in the manufacturing of chocolate, compared to something such as a car or metal incorporated products. With the structure of this franchised retail and manufacturing entity being overseas and local, I expect a lot of different kinds of revenue besides simply sales. Major assets would be the manufacturing equipment and buildings and land. There should not be an exceptional amount of accounts receivable because of the retail nature that uses a lot of cash and credit card transactions. Major liabilities would be wages and salaries payable and accounts payable. I do not expect much long-term debt on large items because stated earlier, they will not have too much major equipment usage.

E

I believe depreciation on equipment, inventory, and wages payable will need to be adjusted before financial statements are made. Depreciation is an estimation, wages payable is an accrued liability, and inventory is a deferred expense, because it was paid for but its usage is not recognized immediately, rather over time. Adjustments are very important for estimations, accruals and deferrals and help make all financial statements up-to-date and verifiable so that money can be allocated appropriately based on it. The general ledger is as follows:

Account Title	Beginning Balance	Purchase Inventory	Incur Factory Wages	Sell Inventory for Cash and on Account	Pay for Inventory	Collect Receivables	Incur SG&A (Cash and Payable)	Pay Wages
Cash and Cash Equivalent	$1,253,947			$17,000,000	-$8,200,000	$4,100,000	-$2,000,000	-$6,423,789
Accounts Receivable	$4,229,733			$5,000,000		-$4,100,000		
Notes Receivable, Current	$0							
Inventories	$4,064,611	$7,500,000	$6,000,000	-$14,000,000				
Deffered Income Taxes	$369,197							
Other	$224,378							
Property Plant and Equipment, Net	$5,253,598							
Notes Receivable, Less Current Portion	$124,452							
Goodwill, Net	$1,046,944							
Intangible Assets, Net	$183,135							
Other	$91,057							
Accounts Payable	$1,074,643	$7,500,000			-$8,200,000			
Accrued Salaries and Wages	$423,789		$6,000,000					-$6,423,789
Other Accrued Expenses	$531,941						$3,300,000	
Dividend Payable	$598,986							
Deffered Income	$142,000							
Deffered Income Taxes	$827,700							
Common Stock	$179,696							
Additional Paid-in Capital	$731,180							
Retained Earnings	$5,751,017							
Sales	$0			$22,000,000				
Franchise and Royalty Fees	$0							
Cost of Sales	$0			$14,000,000				
Franchise Costs	$0							
Sales and Marketing	$0						$1,505,431	
General and Administrative	$0						$2,044,569	
Retail Operating	$0						$1,750,000	
Depreciation and Amortization	$0							
Interest Income	$0							
Income Taxes Expense	$0							

Figure 2.1

Account Title	Receive Franchise Fee	Purchase PPE	Dividends Declared and Paid	All other Transactions	Unadjusted Trial balance	Adjust for inventory count	Record Depreciatin	Wage Accrual
Cash and Cash Equivalent	$125,000	-$498,832	-$2,403,458	$790,224	$3,743,092			
Accounts Receivable				-$702,207	$4,427,526			
Notes Receivable, Current				$91,059	$91,059			
Inventories				-$66,326	$3,498,285	-$216,836		
Deffered Income Taxes				$92,052	$461,249			
Other				-$4,215	$220,163			
Property Plant and Equipment, Net		$498,832		$132,859	$5,885,289		-$698,580	
Notes Receivable, Less Current Portion				$139,198	$263,650			
Goodwill, Net					$1,046,944			
Intangible Assets, Net				-$73,110	$110,025			
Other				-$3,007	$88,050			
Accounts Payable				$503,189	$877,832			
Accrued Salaries and Wages					$0			$646,156
Other Accrued Expenses				-$2,885,413	$946,528			
Dividend Payable			$3,709	-$1	$602,694			
Deffered Income	$125,000			-$46,062	$220,938			
Deffered Income Taxes				$66,729	$894,429			
Common Stock				$1,112	$180,808			
Additional Paid-in Capital				$315,322	$1,046,502			
Retained Earnings			-$2,407,167		$3,343,850			
Sales				$944,017	$22,944,017			
Franchise and Royalty Fees				$5,492,531	$5,492,531			
Cost of Sales				$693,786	$14,693,786	$216,836		
Franchise Costs				$1,499,477	$1,499,477			
Sales and Marketing					$1,505,431			
General and Administrative				-$261,622	$1,782,947			$639,200
Retail Operating					$1,750,000			$6,956
Depreciation and Amortization					$0		$698,580	
Interest Income				-$27,210	-$27,210			
Income Taxes Expense				$2,090,468	$2,090,468			

Figure 2.2

Account Title	Consultant's Report	Pre-Closing Trial Balance	Closing Entries	Post-Closing Trial Balance	Actual February 28, 2010 F/S Figures
Cash and Cash Equivalent		$3,743,092		$3,743,092	$3,743,092
Accounts Receivable		$4,427,526		$4,427,526	$4,427,526
Notes Receivable, Current		$91,059		$91,059	$91,059
Inventories		$3,281,449		$3,281,449	$3,281,449
Deffered Income Taxes		$461,249		$461,249	$461,249
Other		$220,163		$220,163	$220,163
Property Plant and Equipment, Net		$5,186,709		$5,186,709	$5,186,709
Notes Receivable, Less Current Portion		$263,650		$263,650	$263,650
Goodwill, Net		$1,046,944		$1,046,944	$1,046,944
Intangible Assets, Net		$110,025		$110,025	$110,025
Other		$88,050		$88,050	$88,050
Accounts Payable		$877,832		$877,832	$877,832
Accrued Salaries and Wages		$646,156		$646,156	$646,156
Other Accrued Expenses		$946,528		$946,528	$946,528
Dividend Payable		$602,694		$602,694	$602,694
Deffered Income		$220,938		$220,938	$220,938
Deffered Income Taxes		$894,429		$894,429	$894,429
Common Stock		$180,808		$180,808	$180,808
Additional Paid-in Capital		$1,046,502		$1,046,502	$1,046,502
Retained Earnings		$3,343,850	$3,580,077	$6,923,927	$6,923,927
Sales		$22,944,017	-$22,944,017	$0	$0
Franchise and Royalty Fees		$5,492,531	-$5,492,531	$0	$0
Cost of Sales		$14,910,622	-$14,910,622	$0	$0
Franchise Costs		$1,499,477	-$1,499,477	$0	$0
Sales and Marketing		$1,505,431	-$1,505,431	$0	$0
General and Administrative		$2,422,147	-$2,422,147	$0	$0
Retail Operating		$1,756,956	-$1,756,956	$0	$0
Depreciation and Amortization		$698,580	-$698,580	$0	$0
Interest Income		-$27,210	$27,210	$0	$0
Income Taxes Expense		$2,090,468	-$2,090,468	$0	$0

Figure 2.3

Income Statement is as follows:

Revenues:	Amount:
Sales	$22,944,017
Franchise and royalty fees	$5,492,531
Total Revenues	$28,436,548
Costs and Expenses:	
Cost of Sales	$14,910,622
Franchise Costs	$1,499,477
Sales and Marketing	$1,505,431
General and Administrative	$2,422,147
Retail Operating	$1,756,956
Depreciation and Amortization	$698,580
Total Costs and Expenses	$22,793,213
Operating Income	$5,643,335
Other Income(Expense)	
Interest Expense	$0
Interest income	$27,210
Other, net	$27,210
Income Before Income Tax	$5,670,545
Income Tax Expense	$2,090,468
Net Income	$3,580,077
Basic Earnings per Common Share	$1
Diluted Earnings per Common Share	$1
Weighted Common Shares Outstanding	$6,012,717
Dilutive Effect of Employee Stock Options	$197,521
Weighted Average Common Shares Outstanding, assuming Dilution	$6,210,238

Figure 2.4

Balance Sheet is as follows:

Assets	Amount:
Current Assets:	
Cash and Cash Equivalents	$3,743,092
Accounts Recievble	$4,427,526
Notes Receivble, Current	$91,059
Inventories	$3,281,449
Deferred Income Taxes	$461,249
Other	$220,163
Total Current Assets	$12,224,538
Property and Equipment, Net	$5,186,709
Other Assets	
Notes Receivable, Less Current	$263,650
Goodwill, Net	$1,046,944
Intangible Assets, Net	$110,025
Other	$88,050
Total Other Assets	$6,695,378
Total Assets	$18,919,916
Liabilities and Stockholder's Equity	
Current Liabilities	
Accounts Payable	$877,832
Accrued Salaries and Wages	$646,156
Other Accrued Expenses	$946,528
Dividend Payable	$602,694
Deferred Income	$220,938
Total Current Liabilities	$3,294,148
Deferred Income Taxes	$894,429
Commitments and Contengencies	$0
Stockholder's Equity	
Preferred Stock, $.10 par value; 250,000 authorized	
0 shares issued and outstanding	
Series A Junior Participating Preferred Stock, authorized 50,000 shares	
Undesignated series, authorized 200,000 shares	
Common Stock, $.03 par value; 100,000 shares outstanding;	$180,808
6026938 and 5989858 shares issued and outstanding, respectively	
Additional Paid in Capital	$766,602
Retained Earnings	$6,923,927
Total Stockholder's Equity	$14,731,337
Total Liabilities and Stockholder's Equity	$18,919,914

Figure 2.5

Cash Flow Identification is as follows:

Cash Flow Identification:

1. Operating
2. Operating
3. Operating
4. Operating
5. Operating
6. Operating
7. Operating
8. Operating
9. Investing
10. Financing

Adjusting Transactions:

12. Operating
13. Investing
14. Operating
15. Investing

Figure 2.6

Case Study 3: In-Class Reflection

Introduction:

This case is a subjective reflection and analysis of an in-class discussion over multiple scenarios relating to the study of accounting at the University of Mississippi, and multiple future paths in accounting. The structure of the in-class discussion was debate style, with opposing views physically positioned on different sides of the room. Dr. Dickinson acted as a mediator and created the questions that were discussed based on real life conversations that she was involved in. Students in class were chosen to act out the conversation exchange so that everyone else could simulate being there. Our intentions, as students in similar situations, were to decide on a personal level if we agree or disagree with a certain view within the exchange. Some debates over the scenarios were overwhelmingly one-sided while others were fairly matched. Not only was it a good way to get one's opinion established in a room of their peers, but it was great public speaking practice and a way to understand classmates and their views on the world and their future. Throughout this case, each scenario will be summarized, each side with be established and rationalized, then my personal views will be attached at the end. There are/were no right or wrong answers, but certain logics and ethics were tested. Overall, this case stresses the high quality of the accounting school at the University of Mississippi and anyone involved, not matter the extent, can benefit greatly from its attributes.

Scenario 1: Law school after studying accounting and having an accounting internship

This exchange was between two accounting students in Conner hall. One student was adamant about being a lawyer one day based on a family member that does tax law and makes a healthy living. The student outlines his path of studying accounting at Ole Miss and even acquiring an internship with a large accounting firm, due to how good it looks on a resume and the experiences that can be gained. The other student in this situation questions the aspiring lawyer about why he or she is studying accounting and taking an internship spot away from an aspiring public accountant, when everyone knows it is a very limited opportunity. This student also suggests staying and obtaining a masters of accounting instead of law school. The room was split based on how everyone felt about the aspiring lawyers career route plan. Some believed he should stick with the accounting graduate school and do tax with an accounting firm. The others believed he should continue on his route and get a law degree and do tax law with a law firm. Benefits with going to graduate school for accounting at Ole Miss is that it is cheaper than law school, has an incredible job placement, and keeps his degree/internship/career consistent. The benefits to going to law school while studying accounting and pursuing an internship, is that it increases his chances of getting into law school, the student will have a law degree which can potentially earn more money, and it aligns with their aspirations of being a lawyer.

Personally, I believe the student wanting to go to law school and do a faction of tax law should do whatever it takes to get into that program. If this student is studying accounting and performs well enough to gain an internship, they should take it, gain experience, and leverage it to get into law school. In a capitalistic society, merit is rewarded, and if one doesn't do everything needed to excel, then they will not excel. If this student denies an internship, someone else will take it and gain that experience. Specific to this scenario, Ole Miss has a great accounting school and institutions/employers around the country know this. Large accounting firms are actively recruiting students on campus to work for them in the future. When a student gains experience from a large firm on their resume, it shows that with all of its potential recruits, that firm chose this student based on many qualifications they believed stood out amongst others. This increases opportunities in the future because anyone else looking to hire this individual, knows that a very reputable organization hired them in the past. I believe there should be nothing stopping this student from doing whatever he feels is the best route to get to his end goal.

Scenario 2: Studying accounting when not wanting to be an accountant one day

This situation is a conversation between three students. Two students are discussing that they do not want to be an accountant in their future, but are still pursuing an accounting degree from Ole Miss. Their future path wants to be in the investment banking or financial consulting world after working for a firm for a few years out of college, using an accounting firm as a 'stepping stone'. Their reasoning is because the accounting school is above par, and the business school is not. The third student questions their logic and asks why they do not study banking and finance when they want to have a career in banking and finance one day. The room was split between students who believed it made sense to study accounting at Ole Miss even though accounting wasn't in their future and between people who thought they should change to a banking/finance major. The benefits to staying with an accounting major is that it is a highly rated program, and there is a large possibility of being recruited by a big accounting firm, which can serve as a doorway to an investment banking job, which is extremely hard to get right out of Ole Miss undergrad. Benefits to acquiring a banking and finance major is that one gains more specified investments knowledge and that it aligns with the career path they are striving for.

I believe the third student who questions the other two has very straight-forward logic that would make sense in a perfect world. However, the world is not fair and equal. The University of Mississippi business school and its multiple finance/banking degrees are weak compared to other schools. Many outsiders of the school understand this and there is very little investment banking recruitment occurring on campus, putting students at a disadvantage. If an individual is at a school and assumed to not have the possibility of leaving, it would be in their best interest to choose the most profitable and successful major, holding cost of tuitions constant between the two degrees. For example, if a man were put into a room with a steak and two knives, one knife being dull and one being sharp, after being told he can eat the steak, the man will choose the sharp knife every time. There is one task in front of the man, to eat the steak, and he will choose the easiest, most efficient way to do so. This is the same logic used, there is an end goal and two ways of getting there, everyone will choose the route with the highest chance of success. This particular scenario resounds with me on a personal level because I have similar thoughts. I have interests and goals to work in the investment banking/private equity investments space, and I will do whatever it takes to get there. Accounting is the language of business and it is similar in many ways to finance and other financial professions. Also, an accounting major is harder to acquire than a finance major based on class strength and time dedication, and a future employee understands that a student completed more challenging tasks successfully, highlighting hard working attributes that future employers look for.

Scenario 3: Past student asks for advice on requesting a change of work location

In this situation, one of Dr. Dickinson's previous students has emailed her asking for advice on how to go about requesting a location change from Washington D.C back home to Dallas, TX. This request comes after the completion of an internship in Washington D.C. and soon before they start full time at the D.C location. The item in question is not whether or not the student should have asked her previous teacher for advice, but whether this is an appropriate request to her employer and if it comes across as disrespectful or troublesome. The room was split based on the appropriateness of asking an employer this question. With the view of satisfying one's employer, many people in class did not believe this is an appropriate thing to ask. However, there is a danger of a response from the firm such as, “if you do not want to be here, then get out”.

On a personal level, I completely understand how a recent intern is requesting to move locations can be seen as a nuisance after dedicating time and money to train them. Many individuals that have been with a firm for years do not have the luxury of moving to a different location based on preference, and it could be seen as disrespectful to the staff and the entire system. However, I am a firm believer of individuals being more productive where they are most comfortable. One’s life is more important than satisfying a firm’s system of placement and hierarchy; However, this needs to be taken with a grain of salt. If the request is reasonable, I believe there is no harm in attempting to move; however, if there is no convincing evidence to back up the reason for change, it should not be requested. Convincing evidence would be proof that productivity would increase or that the intern will dedicate multiple years to the firm in that location. These two things would be mutually beneficial to the employee and firm. Moving to another location because they have intentions of quitting, or slacking off because they are in a more ‘fun’ city would not be grounds for a transfer.

Case Study 4: Dr. Cantrell- Generic Bank

Introduction:

Throughout this case I have learned a lot about the Audit practice that I did not know previously. I was and still am very intrigued by how unique each situation is and how much referencing is needed, along with the interpretation involved in each reference. I had always assumed there was a “cookie cutter” solution to most things that auditors would apply to each and every situation. Businesses and other economic entities are different, and that can be attributed to its industry, but heavily on its managers and executives. Items are classified differently and decisions are made differently from firm to firm. This case was an excellent way to simulate a real challenge accountants and other interest-sharing parties are faced with. This case has demonstrated many skills needed for a successful auditor such as abstract/critical thinking, interpretation of codes, procedures, and standards, and effective implementation backed by a sufficient explanation and reasoning. I did not enter this case study with much knowledge of comprehensive income, unrealized gains, and impairments; so, the interpretation and decision making on these items’ behalf, came as a challenge. Many references created by regulating and standard-setting entities proved useful in understanding the situations and requirements in this case. After sifting through mounds of financial codifications set by regulators and procedures established by large accounting firms, I have realized how much precise detail is imbedded into each scenario. I have also learned how codifications are similar to a document like the constitution, in that it can be interpreted in different ways, allowing flexibility, but simultaneously causing discrepancies and uncertainties. After completing this case I can confidently say I have improved many skills useful to accountants, the same skills that are needed in satisfying client needs and being successful in the auditing space. I have found a great deal of appreciation for auditing accountants’ daily operations and problem-solving skills.

Requirement One:

The challenge in this requirement was to state whether or not Generic Banks has incurred any impairment losses on the seven securities designated above in 20x2. To get started we must reference the exact securities which are listed with CUSIP numbers ending in: 003, 015, 025, 030, 067, 076, 096. After examining these numbers, it is realized that only five of these securities have a fair value lower than its amortized cost, which is identified in this case as a loss or unrealized loss. The other two securities that make up the seven that were sold are securities with ending CUSIP numbers of 067 and 096. The two securities stated here were sold with a gain on the sale. Now that these securities are established, one may look at a few more factors that outline the criteria for an impairment of an unrealized loss. It is stated in the case and in ASC 326-30 (in paraphrased terms) that banks must identify if an unrealized loss positions is impaired. One determination depends if the decline in value comes from credit loss or from cyclical changes in interest rates or market activity. If the latter is identified as a possible cause, then a determination must be made if the bank has the intent or ability to hold the unrealized losses until they have recovered, if so, they are not deemed impaired. Now referencing the given literature from the case, one is told that the CFO, Joshua Winters, has intentions to free up liquidity in order to give out year-end bonuses to employees and for future acquisitions. It is also stated that the bank has does have other means to raise its needed liquidity in the form of FHLB advances and Federal Funds. The bank also has slack in its capital ratios. Finally, these liquidity needs are based off *voluntary* strategic choices.

With these facts stated, one may infer that the bank has the ability to hold these securities for recovery, but not the intent. Since the bank's intentions were not to hold the securities it is understood that the ones sold with a loss, should be impaired, taken from comprehensive income, and effect net income.

Requirement Two:

This situation asks the reader to judge whether or not the remaining securities, that is the total less the ones sold in requirement one. Using the same logic and guidelines before, one concludes that the remaining securities do not have an impairment loss. The path to this conclusion follows. I am referring the second stipulation that comes from a cyclical change in rates and market activity. If the bank can assert that it has the intent and ability to hold these securities until recovery, then they are not impaired. Simply the fact that these securities are being held, and have not been sold suggests that the bank has the ability to hold them. The bank has other means of liquidity, and the one they exercise was selling certain securities (resulting in the impairment) and leaving others. If the bank did not have the ability to hold the securities, they would have sold them. I also believe that the bank does *not* have the intent to sell them. This is understood because again, there are other means to strategic liquidity needs that can be exercised, and also previous securities were sold, and the remaining securities in question were intentionally held. These securities are being held in order to recover, which solidifies no impairment.

Requirement Three:

The third requirement asks the reader if answers to previous requirements change, based on the view/position of the reader: external auditor compared to bank regulator. I believe there can be differences in answers based on role. An auditor has more intentions of seeking out fraud, ensuring accounting principles, and assumptions, and fundamental qualities of accounting guidelines in order to protect the banks credibility and other investors. The external auditor cannot give its professional stamp on an audit if they feel that there are any discrepancies' or fallacies within an entity's intentions of financial position. An accounting firm can lose its reputation after giving a report of good standing, then later the reporting entity turns out to have been involved in securities fraud. On the other hand, a bank regulator my not have as many tight constraints on a bank and its securities, liquidity strategy, or things of that nature. For one, a bank regulator such as the Federal Reserve system, or legal regulations set in place to protect banks have a biased towards the success of the banking system. Based on the "too-big-to-fail" theory, a government or its regulatory agencies may act as a government safety net for large or important banks. The overall goal is to maintain confidence in the banking system and prevent bank failures. Bank regulators may not look too deep into a bank's sale of securities in order to free up liquidity after executives assert their intentions. Bank regulators want to see healthy and more liquid banks to improve consumer confidence, easing the burden on regulators. Overall, both roles are in place to ensure the safety and reliability of a bank's financials, and I strongly believe both roles pursue each situation with great accuracy; however, in order to answer the requirement, I do believe there could be a small discrepancy in answers based on how one role may view this situation.

Requirement Four:

Requirement Four asks one to assess whether answers from both requirement one and two would change based on the fact that the securities sold were in a net gain position. Based on accounting codifications, each security needs to be evaluated individually and not in a net position. From the outside, seeing a net gain would look harmless, because they were not sold as an overall loss. However, within the net there are some securities in the loss position still. Under FASB ASC codification 320-10-35-20, impairment shall be assessed at the individual security level. This means that we have to look at each any every security, to determine impairment. Based on requirement one, using the same securities, the remaining securities in the loss position would need to be labeled as impaired. The next portion of requirement four asks if the answer would change if every security was sold in a gain position. Based on the overall idea of impairment being the assessment of losses on securities. KPMG's "FRS 109 Financial Instruments- Impairment for Corporates" literature begins with defining default, which is significant in stating the "why" or motive of identifying impairment. I do not believe that there is any need for any security to be identified as impaired. If there is no default, or loss of value in certain securities, there is no need to initiate the impairment evaluation process. Selling these securities as gain is a normal and ideal occurrence of securities trading. Proceeds can be reinvested or relayed into owner equity.

Requirement Five:

The last requirement of the case alters the scenario more dramatically. Generic bank is now only adequately capitalized rather than well capitalized. The banks intentions are to sell securities to improve capital ratios and to fulfill other obligations on its balance sheet. It also states that other methods of reaching desired liquidity is now limited.

With these alterations, the same question is asked as in requirement one and I believe the method of deciding impairment changes. One requirement of the bank is to assert that it has the ability and intention to hold the securities until recovery. I do not believe that the bank has the ability or the intent to hold these securities till recovery. First, the bank has obligations or liabilities to meet and need to be more liquid in order to fulfill those needs. Along with this, other methods of reaching liquidity are limited. The bank is openly attempting to improve its ratios, a strategic intention. This would assert that selling the stated securities align with attentions not of holding till recovery. With these things being said, I believe the bank does not have the ability *or* intent to hold the said securities. These securities should be identified as impaired, with similar effects to comprehensive income and net income just as requirement one.

Case Study 5: City Case

Introduction:

This case has been a great opportunity to learn and be forced to do research on two cities we have interests living in one day. The format I chose was to answer the question for each city back to back, so that I could more easily compare the answers. There were a lot of similarities based on the content of each question, but truly these cities are far more different in terms of culture, politics, and overall ‘vibe’. They are similar in ways that all larger cities are, public transportation, sports teams and entertainment, high costs of living, etc. I have been very excited to get to know more about more logistical, structured things about the cities I want to live in rather than just focusing on the fun and social aspects. For background, I have spent a lot of time in Dallas growing up and more recently in my college years visiting friends at Southern Methodist University. I feel that I have a true grasp on culture, social life, and activities for young adults in the city. New York City on the other hand is more of an unknown, which is both exciting and intimidating at the same time. I have visited multiple times and have always felt that it would be a great place to live out of college for a short period, but not for an extensive amount of time. Dallas however, I would consider living the rest of my life there. This case has taught me how to value more than the social aspect of my decision-making process.

City one: Dallas, Texas

City Two: New York, New York

Population of Dallas:

The 2016 estimated population is around 1.3 million. The entire Dallas-Fort Worth area is around seven million.

Population of New York City:

The city alone has 8.6 million people, and its metro area has over 20 million.

Climate of Dallas:

Dallas is technically humid subtropical similar to where I grew up in Jackson, Mississippi, but it is dry and windy, a characteristic of the southern plains

Climate of New York City:

New York is Costal and located in the extreme Northeast. New York can have hot summers, but also very cold and snowy Winters. I have spent time in New York through much of November, and it was not uncomfortably cold. New York City is also called an “urban heat island” because of its structure, population, and activity making the surrounding environment warmer than outside the city.

Geographic characteristics of Dallas:

Dallas is flat and does not contain many trees, it is "wide open" and expansive scenery with low lying trees, if any. Eastern Texas is very similar landscape compared to Louisiana or Mississippi. Western and Northern Texas are more flat, dry, and similar to the grasslands. The city itself is large with many districts that are distinct from one another, there are also many surrounding suburbs in the area with many people and more residential housing.

Figure 5.1

The picture above shows Dallas' great skyline at night. Dallas has a large and concentrated city center.

Geographic Characteristics of New York City:

New York City is undoubtably large and extremely urban for many miles in each direction of the city center. New York is surrounded by and bordered by water. The surrounding areas of New York are costal and lush green. The nickname "concrete jungle" fits well because within the city where I would potentially live and work would not have much nature to interact with.

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Figure 5.2

This image shows the layout of the entire city, and as one can tell, there is very little green.

Dallas Taxes:

Texas has a sales tax of around 6.25%, but larger cities in Texas, such as Dallas, has a sales tax of about 8.25%. Texas does not have state or local income taxes, however there are hefty sales and property taxes.

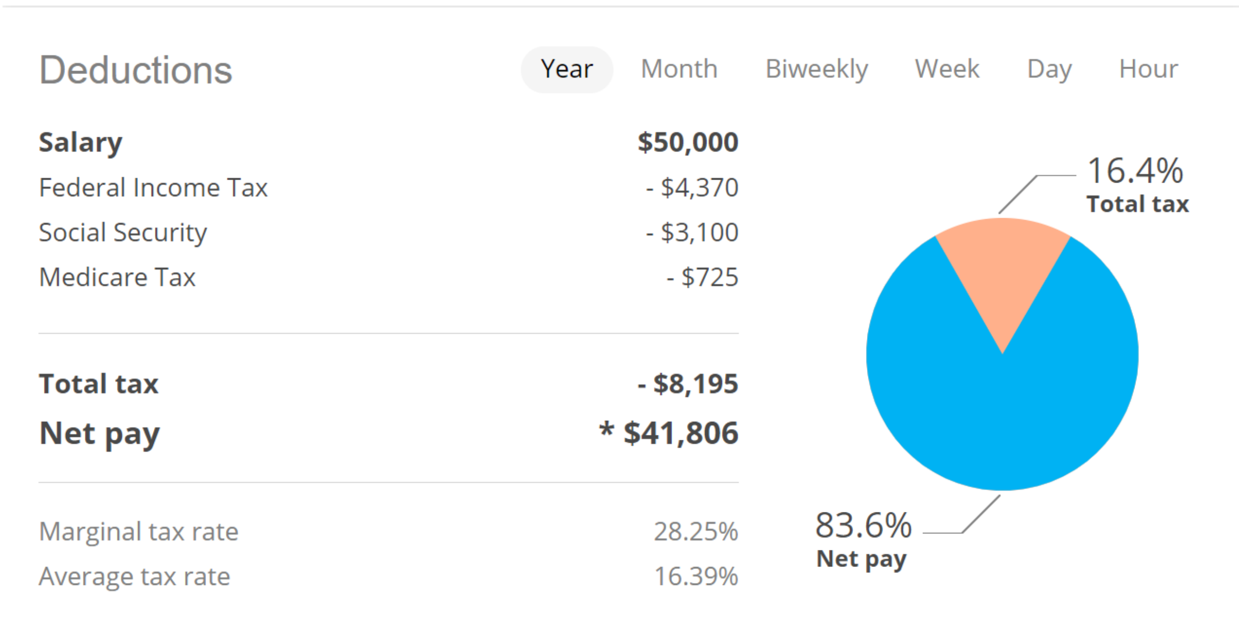

Figure 5.3

This chart above was taken from Nuevoo Tax Calculator, which uses up to date tax information from each state and applies them to any salary range. State and local property taxes are just under 3%, which would also be taken from this income pie.

New York Taxes:

On the contrary to Dallas, New York is a pretty heavily taxed city in the United States, due to political differences. New York City has its own income taxes along with state and federal taxes. New York State is also known to have some of the highest property taxes in the country.

The city of New York also has its own sales taxes along with the rest of the state's sales taxes. Marginal tax rates on a 50,000-dollar salary would be around 34%.

Transportation Dallas:

Luckily, there many convenient ways to get in and out of Dallas from out of state, also ways to get around within the city. Southwest Airlines has its main airport, Love field, very close to downtown Dallas. DFW airport is also located between Dallas and Fort Worth, which is a major hub for American airlines. I fly in and out of both of these two airports multiple times a year and can always find a great price with either, however Love field is more convenient. Within Dallas, the public transportation is called DART (Dallas Area Rapid Transit) which is an above-ground rail system. Dallas, along with a few more major cities has allowed companies to come in and set up "bike shares" which are dock less bikes than can be picked up from the street, ridden, and left at your destination after paying. This is a fun and environmentally friendly way to get around Dallas, especially when traveling short distances downtown.

Transportation New York City:

New York City has a lot of public transportation. Opposite of Dallas, people very rarely own personal vehicles because of how many taxi, uber, extensive subways, and the ability to walk. One benefit to not having a car, is not having to pay for it, which can prove to be a large expense. JFK and La Guardia are two major airports in NYC that have many national and international flights. They are not as close to Manhattan as Love field is to downtown Dallas, but only a train or taxi ride away. Grand central station is also nearby and a very common way for people to travel between the large Northeastern cities, and to commute to work from outside the city.

Industries of Dallas:

Dallas has a large amount of heavily prevalent industries based on its sheer size. The biggest would include Tech/Telecommunications, Financial Services, and Transportation. AT&T, American Airlines, Southwest Airlines, Comerica Bank and a plethora of other investment banks and private equity firms. These companies are very large and employ a large part of the population in Dallas. These are all growing and establish industries that do not seem to be leaving anytime soon. These things bring in a lot of money to the city and spur the economy, while giving back and supporting the local culture through things like AT&T stadium and the American Airlines center.

Industries of New York City:

Financial services are the bread winners for the city. The New York Stock Exchange is based in NYC, which is the most influential securities exchange in the world. Along with this, many investment banks are based here, such as Goldman Sachs, JP Morgan, Merrill Lynch, Citi Bank, and many others. There are also very large private equity shops moving billions of dollars. Healthcare is another large industry in New York, primarily in biotech and pharmaceutical developments such as Pfizer. Manufacturing has always been a large industry in New York since the United States' industrial revolution. Since New York City is a port city, trade is a large industry that provides many jobs and opportunities. A lot of things are shipping in and out of New York, a lot of professional services are involved in the management of the trade industry and the other industries listed above.

Healthcare of Dallas:

Dallas has many great hospitals such as Baylor University and Texas Health Presbyterian. Texas was also ranked the 6^{th} least expensive place for personal health care expenses. Some criticisms have been given to some of the hospitals in Dallas, which is a concern of mine. However, there are many private medical practices in Dallas that have world renowned surgeons and medical professionals, but the downside there is that it can get expensive.

Healthcare of New York City:

Along with the health-centered company headquarters based in New York, there are abundant hospitals. New York is considered a global center for healthcare. There are approximately 60,000 physicians in the city alone. Based on political movements, NYC has very affordable and accessible healthcare, opposite of Dallas.

Crime rates of Dallas:

Along with any large city, there will be crime associated based on many different variables such as income distribution, quality of schools, and culture. Dallas is slightly below average for crime rates compared to other large cities such as Chicago, Houston, Miami, and Atlanta. There are about 7.6 violent crimes per 1000 residents in Dallas. Highland Park and University Park are the safest areas in all of Dallas, and two of the safest places in the entire country. South downtown and South of there have the highest crime rates in Dallas.

Crime rates of New York City:

As one can imagine, the largest city in the country has crime. In the 90's, New York was labeled the murder capital of the world, with over 2,000 murders. Now in 2017 there were only 290 murders and it has been steadily declining. Now NYC can be dubbed the safest big city. Its murder rates are lower than cities with smaller populations. As always, there are areas of the city that are more dangerous than others. Brooklyn Heights is one of the more dangerous areas. Muggings are a common crime in New York, and are often targeted towards tourists, not as much locals. This is very common in heavily vacationed cities, especially overseas. The areas I would prefer to live-in would-be Greenwich Village, the upper east side, or SoHo Manhattan, which are all lively and safer areas.

Rent of Dallas:

The average rent in Dallas is $1157 and with an average square footage of 851. The area that I would prefer living in would be uptown. It is a little livelier and has a younger crowd filled with many bars and restaurants. I spend a lot of time in this area every time I visit friends and family in Dallas. However, this area is more expensive and the average rent is closer to $2,000 a month. Many of my friends that go to school in Dallas have said people can pay $1300 a month for only 750 square feet. That is expensive, but these locations are very new and in a great location. I believe I would live with another person or two for at least the first two years, then hopefully as my salary rises, I can move to a place by myself. There is usually abundant parking in and around the apartments, normally in parking garages on the first floor. Finding parking on the street can be hard to do, but one great reason for living uptown, walking to restaurants and even work is common.

Rent of New York City:

This is one of the most controversial and debated parts of NYC. Rent is very expensive, and living with roommates is an absolute must, for multiple years of one's life. The average cost of a "modest" two-bedroom apartment is around $3,700 a month. In order for one to spend less than 28% of one's salary on rent, one would need to make 162,000 dollars a year, which is about four times the average annual income in the United States. After working a few years and living downtown, I believe I would move out of the city and buy a home rather than an apartment.

Commuting in Dallas:

Dallas is still a heavy driving city, as many people come in from surrounding areas such as Plano. Assuming I were to live in Uptown Dallas, and work either downtown or possibly Uptown, I believe I would ride a bike, or drive a short distance. I have traveled from uptown to downtown in the mornings and evenings, and every time between and the traffic is not very bad. The worst traffic is on the interstate attempting to leave or enter the city from another city. I assume my commute times from University Park/Uptown would be about ten minutes.

Commuting in New York City:

Commuting is quite different here than in Dallas. Depending on where one lives, it is very feasible and common to walk or ride a bike to work. Riding the subway is also widely common. There are cards to use the subway systems that are under $200. I believe I would enjoy walking to work each day if I lived close enough, it would be an exciting walk to work. If I were to live further away from work, I would definitely take the train into town, then walk a short distance. Traffic in New York can get hectic, and walking can sometimes be faster than driving in certain areas.

Shopping in Dallas:

I debate whether or not I will grocery shop too often, or eat out. Depending on food presences, prices, and time. There are a lot of amazing places to eat in Dallas, and they are not wildly overpriced. However, whenever I do shop, I am okay with spending more money on items from Whole Foods rather than Wal Mart. There is a whole foods and target both Uptown, a few minutes from common apartment complexes. If I were to live with someone, splitting groceries would be possible if we had the same diet and food preferences.

Shopping in New York City:

Similar to Dallas, I am not sure how much I will cook or have the need to grocery shop based on time limitations and cooking space in a small apartment. I believe I would walk to the grocery store, maybe a local produce stand, to get fresh and necessary items like milk and eggs. I believe I would eat out a lot even though it can be more expensive to do so.

Laundry in Dallas:

In Dallas, many of the apartment complexes that I have visited have a washer and dryer in each unit. I would plan to use the machines provided, which I am sure its usage is either included in the cost of rent or paid out through utility bills.

Laundry in New York City:

Depending whether the unit I rent has a machine, or maybe one in the building, I will use what the apartment provides. There are also laundry services that pick up and deliver similar to rebel laundry here in Oxford.

Organizational Involvement in Dallas:

I plan to be heavily involved in a local Church, specifically Episcopalian. I have been to Highland Park Presbyterian located on SMU's campus, but have not found an Episcopal church yet. I would also like to be involved in Habitat for Humanity. I enjoy physical labor and helping people in need. Building homes seem to be a great way to help the community, while also staying active and healthy. I also have interests in the Perot Museum for Nature and Science, and Dallas museum of Art. I would like to be involved in these two museums in some way, whether it be donations, working events, or possibly playing some sort of role on the Board of Directors some day in the future.

Organizational Involvement in New York City:

I believe my interests in involvement would not change based on what city I live in, except for habitat for humanity, which is not as prevalent or as feasible in the city. I would like to be involved with an Episcopal church in the city, and also work for an organization that helps feed the hungry or support low income families. My third organization would also be in support of the New York hall of science, or one of the many science museums in the area that educates all ages.

Activities in Dallas:

I really enjoy sports. I believe I would spend a lot of time watching the Dallas Cowboys, Texas Rangers, Dallas Stars, and even the SMU mustangs football team. There is plenty of opportunity for food tours, which I am a big fan of and have done before in Dallas. With the many stadiums and venues, there is always musical talent coming through Dallas. I plan to attend the large names and find smaller artists in the smaller venues. I plan to be a part of some sort of cooking school or class, as that is an interest of mine. There are many classes taught by famous chefs in the city that allow individuals to learn new cooking techniques. I am a large outdoorsman, there are hunting and fishing activities found nearby Dallas. There are ranches outside of Dallas with plenty of opportunity.

Activities in New York City:

New York has many sports teams that I would be in huge support of. I see myself going to Giants, Yankees, and Knicks games anytime I have the opportunity. I primarily enjoy football, and there are two professional teams in NYC. I believe I would travel outside the city to a surrounding state's mountainous regions since I would be in close proximity. I have a great interest I fly fishing, which can be done off the New England coast, or the mountains of Vermont and New York state. I believe I would be heavily involved in the food scene of the city, there are so many cultures and cuisines to try and a never-ending source of new restaurants.

Traveling Home from Dallas:

I have traveled from Jackson to Dallas many times. I have driven and flown. Flying is the easiest but most expensive. However, flights can be found for under 200 dollars and that is when I decide to fly. Driving to and from takes just under six hours. The average cost for driving is 150 dollars, which includes two tanks of gas and depreciation of one's vehicle, (oil usage, tire wear down, etc.). If one's vehicle does not get great gas mileage, or is old, flying can make more financial sense if the prices are low and tickets are booked in advance.

Traveling Home from New York City:

I believe my only option would be to fly out of La Guardia or JFK. I would not own a car in the city so driving would not be an option. Another option, but less convenient would be to take the train. The costs of getting home from New York would be much higher than from Dallas, a couple hundred dollars more. It is harder to find flights back to Jackson, MS.

Budget for both Dallas and New York City:

	Operating Income assuming $60,000 annual salary			
		budget broken into months		
New York City			Dallas, TX	
Income-	5,000		Income-	5000
Rent(split 3 ways)	1100		Rent(split 3 ways)	500
Subway pass	125		Car payments +Insurance	700
Groceries	200		Groceries	150
Eating out	600		Eating Out	400
entertainment	600		Entertainment	500
Uber	150		Uber	180
misc. shopping	400		Misc Shopping	400
total expenses	3,175		total expenses	2,830
total leftover	1,825		total leftover	2,170

Figure 5.4

Conclusion on Both Cities:

After extensive research on both cities' costs, quality of living, social life, and other items, I believe I prefer Dallas Texas over New York City. I had always preferred Dallas, but now I believe I have solidified it even more. I have been to Dallas more times and feel that I have a truer feeling of the city. I would be worried New York is too different, and I would not want to stay there longer than two years at the maximum. I enjoy southern culture, climate, and costs more than those of New York City. I believe New York city would be a great place to live, but not as great as Dallas. Dallas is large, vibrant, young, fun and not terribly expensive. I have read too many articles describing how “New York isn’t that expensive…as long as you lower your standards of living enough!” I do not agree with this idea at all. The entire point of life is to enjoy living, why would one sacrifice enjoyment of living conditions just for one city or one job? Nobody is promised tomorrow. I believe Dallas would be the best fit for myself and my interests, it is far away from my home and different enough, but still close and familiar enough to feel comfortable.

Case Study 6: WorldCom

Introduction:

As a native of Jackson, Mississippi, I am very familiar with this case and most of what it entails outside of an accounting standpoint. I knew individuals involved and many individuals negatively affected by the entire outcome. There isn't too much open talk about the WorldCom disaster. I am not sure if it is because it is still unknown or if it simply doesn't matter to gossip about, as it has been a while since it happened. Jackson, MS had potential to be a telecommunications center with WorldCom and others such as C-Spire and NetScape. It was very unfortunate to see such a demise of a large entity and all the other entities it brought down with it such as Arthur Anderson. This case has now allowed me to gain insight on what was the true cause of WorldCom's collapse, rather than hearing falsities. This case study has also given me insight on how accounting procedures can alter financial statements and investor relations, no matter if the procedure seems small or insignificant. Change in accounting procedures can affect balance sheets, net income, and cash flows and mislead stakeholders. Many people lost their job and investments due to this accounting mishap. This makes me value the profession more and I hope to act responsibly if I am ever to be in a position like this.

A

i) Defined by FASB, "Assets" are economic benefits that will probably be received in the future. Most assets, especially property, plant, and equipment have long lived lives that will create benefits to the entity. These economic benefits are result of a past transaction to acquire or possibly construct/fabricate. One of the characteristics of an asset is that the owner has control and access to it, while having control of other's access to it. Future benefits could be described as monetary or goodwill. The future benefits technically are not required, but with probable occurrence with reasonable assumption.

ii) Costs can be either expensed or capitalized depending on the situation. Capitalizing usually occurs when the cost object will provide future benefits. It usually involves property, plant, and equipment assets because they generally have long useful lives. Expenses are outflows of using up assets from the process of creating goods or services or any other operation of the economic entity.

B

Costs that are capitalized are wrapped into the total cost of the asset it pertains to. This would increase overall value in fixed assets and assets in general. This would increase financial ratios and increase the firm's overall value. As for the income statement, it will be smoother and more constant. The net income will project a higher number because the costs do not appear on the statement, because they are in the value of the asset. This is a way for firms to disguise costs and make net income look higher than it may truly be.

All journal entries are in thousands

C

As of December 31, 2001, line costs were 14.74 billion dollars

Line costs Expense 14,739

Accounts Payable 14,739

The "line costs" are the costs are the costs incurred of laying done lines in the earth for telecommunication purposes. This is a common cost for this industry and a common operational cost for a company such as WorldCom. This gives justification for these costs to be expenses rather than capitalized.

D

Costs that were improperly accounted for were "charges paid to local telephone networks to complete calls". The transactions that these costs come from are when WorldCom must pay telephone networks. WorldCom would pay telephone networks that were operating under their communication services. These costs do not meet the definition of an asset, these do not generate revenue or future benefit to the company. I can possibly understand how these costs could potentially have reason to be capitalized. These contracts with local telephone networks may be contractual relationships that bring benefit to WorldCom. However, these assumptions are not material enough to be capitalized, and must be expensed based on accounting procedures.

<u>E</u>

I believe the incorrect entry for the line costs of 3.055 billion would look like this below:

Transmission Equipment	23,811	
Capitalized Asset	3	
Cash		23,814

Whenever costs are capitalized, they are incorporated into overall cost of an asset that it is associated with. I believe these line costs would be wrapped into something such as communication equipment if they were to be capitalized. The line costs plus the communication equipment value per balance sheet. These costs appeared on the balance sheet in the property, plant, and equipment section of the assets since these are the types of objects that involve capitalization. This increases this fixed asset section along with total assets. In regards to cash flows, I believe that since capitalizations are usually involved with acquisition or creation of assets, I would consider it to be in the investing portion of the cash flow statement. The investments portion would increase by the amount of capitalization, thus lowering cash flows. Overall, the capitalization of these costs allows for financial reports to look more favorable. This is one reason there is such a severe punishment for knowingly accounting costs wrong, it misleads investors and other stakeholders of the company.

F

Depreciation expenses for 2001:

Period	Amount	Useful Life	Total	Percent of Year	Total
Q1	771,000,000	22	35,045,454.50	4Q/4Q	35,045,454.50
Q2	610,000,000	22		3Q/4Q	20,795,454.50
Q3	743,000,000	22		2Q/4Q	16,886,363.60
Q4	931,000,000	22		1Q/4Q	10,579,545.50

Figure 6.1

(Amount/Useful life = Total 1)

(Total 1/Percent of Year = Total 2)

The total depreciation expense for the year of 2001 is: 83,306,818.10

G

Net income corrected from capitalization error:

Net Income before taxes stated December 31, 2001: 2,393,000,000

Add back Depreciation: 83,306,818.10

Take away line costs: 3,055,000,000

Net loss: (578,693,181.9)

Add Tax Benefit of 35%: 202,542,613.66

Net loss: (376,150,568.23)

Since there is a net loss due to the correction, there is a tax benefit rather than a tax expense. This benefit is carried forward to future year's incomes

Case Study 7: Starbucks

Introduction

Before this case study, I was not extremely familiar with Starbucks, its business processes, and cost structure. I understood the basics of how Starbucks made money, by selling coffee and similar items; however, I did not analyze much further. I did not previously know if Starbucks operated under a cash or accrual basis, or how they recorded each sale. This case has allowed me to notice and analyze accounting procedures of all sorts of businesses that I otherwise would not care to think about. Beyond this, I have realized how many different accounting methods and variations of procedures some firms use compared to others. There are rules and regulations in accounting, set by standards boards, but there is also ability to choose one method over another. Most of these variations in methods do not make a substantial material difference, but some may distort the truest numbers or scenario. Starbucks recognizes a litigation expense in 2013 as an operating expense, when others may record it is a non-operating gain or loss. Overall, the firm still loses the same amount of money, but one treatment of the loss may show the firms bottom line differently than the other, which could confuse investors. With no real-world experience in public accounting, I did not fully understand what was needed to be presented to fulfill government requirements, and other interested parties. There is a lot of supplementary information found along with the four main consolidated financial statements. These complementary statements and documents explain and annotate procedures and reasonings for what is shown. This in itself explains how much thought is needed to produce four statements, it is provided to help explain the reasons for certain results. I am fortunate all of these materials are shown, one would be in the dark without them.

A

Starbucks produces and sells coffee products in a retail chain structure. The nature of Starbuck's business is to sell inventory for a profit. Revenue is generated from sales to customers, primarily cash sales. One may notice the large amounts of revenue and cash accounts on the financial statements. Starbucks is a retailer and a wholesaler.

B

Starbucks creates an Income statement, Balance Sheet, Statement of Cash Flows and Statement of Stockholder's equity for external users. Starbucks refers to each of these statements as "Consolidated" because it is incorporating itself and all the information from the subsidiaries it owns. Starbucks owns multiple subsidiaries that are almost direct in to their operations, but some are a branch off, diversifying what they do and how they collect revenue. Overall, each of these subsidiaries and the parent company compile their data for one series of statements. Along with the consolidated statements, each economic entity is reported separately for more precise and in-depth analyzation.

C

Starbucks is a very large public company. Public companies are heavily regulated by the Securities Exchange Commission. The SEC mandates the type of financial statements required and the time frame in which they are presented to the public. The SEC is primarily in place to protect investors and creditors, forcing each company to remain honest and reliable with its reporting. The SEC requires the Income statement, balance sheet, statement of cash flows, and statement of stockholder's equity at each quarter (10-Q) and end of year (10-K).

<u>D</u>

The party responsible for creating and presenting financial statements to the public is the internal management of the reporting entity. Starbuck's internal employees and management team are to create and replicate financial information reliably and accurately. It is important for an entity to have very strong and credible internal controls so that everything is reported correctly. Parties that are potential and common users of financial reports would include, creditors, investors, competitors, and even internal managers again. Internal management can use these statements to improve and alter controls and business procedures based on previous years and quarters. It is essentially a report card for all the activities within the reporting period. Creditors and investors are very common users of this information, so one can decide whether loaning money to the reporting entity is a good or bad idea. An entity quickly and consistently losing money and selling off assets may not be the best entity to loan millions of dollars. Investors can use this information to track growth and efficient use of assets, reduction of costs, and decide whether to invest their wealth. Investors are very interested in cash flows, revenues, debt-to-equity ratios, and other ratios such as price/earnings, and earnings per share.

<u>E</u>

Starbuck's external audit firm is Deloitte & Touche. Deloitte's Seattle, Washington office issued an unqualified opinion for Starbucks' financial statements and controls. This means that Starbucks followed GAAP without any material deviations or weaknesses. Also, their controls over financial reporting is in accordance with regulations without material weaknesses. If the opinion were different (qualified or adverse) that would greatly impact how the public views and relies on Starbucks financial statements. Adverse opinions are rarely issued, especially for public entities, but it would mean that there are pervasive material weaknesses in regards to the following of GAAP. An auditor’s opinion is the outcome or final product of a firm’s assessment and review of the reporting firms’ financial statements, in order to verify the credibility and accuracy. The opinion is intended to make sure there are no material misstatements, GAAP procedures are followed, and internal controls are intact. The first opinion states that each of the statements Starbucks has prepared are in line with accounting rules and regulations. Essentially, everything is faithfully reported and accurate, confirming that external users can rely on this information to make financial decisions. The second opinion is related to the comprehensive aspect of the statements. The opinion states that the statements are accurately reported in line with rules and regulations that concern subsidiary and parent combined reports. These are dated after year end because that is the time it takes for the firm to compile, analyze, and create the financial statements. The year-end must close, then once everything has closed, statements can be created. The financial statements can’t come out reporting the year end, one week before the year actually ends.

F

Consolidated Statements Of Earnings (USD $)	12 Months Ended			Common-Sized Statement		
In Millions, except Per Share data, unless otherwise specified	Sep. 29, 2013	Sep. 30, 2012	Oct. 02, 2011	Percent of Total Revenues		
Net revenues:						
Company-operated stores	$11,793.20	$10,534.50	$9,632.40	79%	79%	82%
Licensed stores	1,360.50	1,210.30	1,007.50	9%	9%	9%
CPG, foodservice and other	1,738.50	1,554.70	1,060.50	12%	12%	9%
Total net revenues	14,892.20	13,299.50	11,700.40	100%	100%	100%
Cost of sales including occupancy costs	6,382.30	5,813.30	4,915.50	43%	44%	42%
Store operating expenses	4,286.10	3,918.10	3,594.90	29%	29%	31%
Other operating expenses	457.2	429.9	392.8	3%	3%	3%
Depreciation and amortization expenses	621.4	550.3	523.3	4%	4%	4%
General and administrative expenses	937.9	801.2	749.3	6%	6%	6%
Litigation charge	2,784.10	0	0	19%	0%	0%
Total operating expenses	15,469	11,512.80	10,175.80	104%	87%	87%
Gain on sale of properties	0	0	30.2	0%	0%	0%
Income from equity investees	251.4	210.7	173.7	2%	2%	1%
Operating income	-325.4	1,997.40	1,728.50	-2%	15%	15%
Interest income and other, net	123.6	94.4	115.9	1%	1%	1%
Interest expense	-28.1	-32.7	-33.3	0%	0%	0%
Earnings before income taxes	-229.9	2,059.10	1,811.10	-2%	15%	15%
Income taxes	-238.7	674.4	563.1	-2%	5%	5%
Net earnings including noncontrolling interests	8.8	1,384.70	1,248	0%	10%	11%
Net earnings attributable to noncontrolling interest	0.5	0.9	2.3	0%	0%	0%
Net earnings attributable to Starbucks	$8.30	$1,383.80	$1,245.70	0%	10%	11%
Earnings per share - basic	$0.01	$1.83	$1.66	0%	0%	0%
Earnings per share - diluted	$0.01	$1.79	$1.62	0%	0%	0%
Weighted average shares outstanding:						
Basic	749.3	754.4	748.3	5%	6%	6%
Diluted	762.3	773	769.7	5%	6%	7%
Cash dividends declared per share	$0.89	$0.72	$0.56	0%	0%	0%

Figure 7.1

Consolidated Balance Sheets (USD $) In Millions, unless otherwise specified	Sep. 29, 2013	Sep. 30, 2012	Common Sized Statement Percent of Total Assets	
Current assets:				
Cash and cash equivalents	$2,575.70	$1,188.60	22%	14%
Short-term investments	658.1	848.4	6%	10%
Accounts receivable, net	561.4	485.9	5%	6%
Inventories	1,111.20	1,241.50	10%	15%
Prepaid expenses and other current assets	287.7	196.5	2%	2%
Deferred income taxes, net	277.3	238.7	2%	3%
Total current assets	5,471.40	4,199.60	48%	51%
Long-term investments	58.3	116	1%	1%
Equity and cost investments	496.5	459.9	4%	6%
Property, plant and equipment, net	3,200.50	2,658.90	28%	32%
Deferred income taxes, net	967	97.3	8%	1%
Other assets	185.3	144.7	2%	2%
Other intangible assets	274.8	143.7	2%	2%
Goodwill	862.9	399.1 [1]	7%	5%
TOTAL ASSETS	11,516.70	8,219.20	100%	100%
Current liabilities:				
Accounts payable	491.7	398.1	4%	5%
Accrued litigation charge	2,784.10	0	24%	0%
Accrued liabilities	1,269.30	1,133.80	11%	14%
Insurance reserves	178.5	167.7	2%	2%
Deferred revenue	653.7	510.2	6%	6%
Total current liabilities	5,377.30	2,209.80	47%	27%
Long-term debt	1,299.40	549.6	11%	7%
Other long-term liabilities	357.7	345.3	3%	4%
Total liabilities	7,034.40	3,104.70	61%	38%
Shareholders' equity:				
Common stock ($0.001 par value) - authorized, 1,200.0 shares; issued and outstanding, 753.2 and 749.3 shares (includes 3.4 common stock units), respectively	0.8	0.7	0%	0%
Additional paid-in capital	282.1	39.4	2%	0%
Retained earnings	4,130.30	5,046.20	36%	61%
Accumulated other comprehensive income	67	22.7	1%	0%
Total shareholders' equity	4,480.20	5,109	39%	62%
Noncontrolling interests	2.1	5.5	0%	0%
Total equity	4,482.30	5,114.50	39%	62%
TOTAL LIABILITIES AND EQUITY	$11,516.70	$8,219.20	100%	100%

Figure 7.2

Shown above are the Common-sized Income statements and balance sheets next to the respective consolidated statement. This tool is extremely helpful when comparing companies of drastically different sizes, and the same company over multiple years. Management can use this view to track major changes in the capital structure, and document trends of the firm’s performance.

G

i) The accounting equation for Starbucks is as follows:

Assets (11516.7) = Liabilities + Stockholder's Equity (11516.7)

TOTAL ASSETS	11,516.70
Current liabilities:	
Accounts payable	491.7
Accrued litigation charge	2,784.10
Accrued liabilities	1,269.30
Insurance reserves	178.5
Deferred revenue	653.7
Total current liabilities	5,377.30
Long-term debt	1,299.40
Other long-term liabilities	357.7
Total liabilities	7,034.40
Shareholders' equity:	
Common stock ($0.001 par value) - authorized, 1,200.0 shares; issued and outstanding, 753.2 and 749.3 shares (includes 3.4 common stock units), respectively	0.8
Additional paid-in capital	282.1
Retained earnings	4,130.30
Accumulated other comprehensive income	67
Total shareholders' equity	4,480.20
Noncontrolling interests	2.1
Total equity	4,482.30
TOTAL LIABILITIES AND EQUITY	$11,516.70

Figure 7.3

ii) Cash and Cash equivalents and inventories are large short-term assets. This makes sense because they are a merchandiser of perishable goods, so inventory is short term and always coming in and out. They upcharge a lot for coffee and make a lot of daily sales, making cash very large on the balance sheet. PPE is very large because of all the brick and mortar stores and factories. As one can see in the chart below, short term assets are 48 percent of total assets. This is logical for a firm such as Starbucks, due to the massive amount of property, plant, and equipment.

Consolidated Balance Sheets (USD $) In Millions, unless otherwise specified	Sep. 29, 2013	Sep. 30, 2012		Common Sized Statement Percent of Total Assets	
Current assets:					
Cash and cash equivalents	$2,575.70	$1,188.60		22%	14%
Short-term investments	658.1	848.4		6%	10%
Accounts receivable, net	561.4	485.9		5%	6%
Inventories	1,111.20	1,241.50		10%	15%
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Deferred income taxes, net	277.3	238.7		2%	3%
Total current assets	5,471.40	4,199.60		48%	51%
Long-term investments	58.3	116		1%	1%
Equity and cost investments	496.5	459.9		4%	6%
Property, plant and equipment, net	3,200.50	2,658.90		28%	32%
Deferred income taxes, net	967	97.3		8%	1%
Other assets	185.3	144.7		2%	2%
Other intangible assets	274.8	143.7		2%	2%
Goodwill	862.9	399.1	[1]	7%	5%
TOTAL ASSETS	11,516.70	8,219.20		100%	100%

Figure 7.4

iii) Intangible assets are assets that are not physical in nature, like patents or contracts. Goodwill is the" name" or essence of a company which Is altered only through acquiring businesses. Goodwill recently acquired Teavana, which caused their goodwill to increase. Other examples of intangible assets Starbucks would have been exclusive contracts with growers, patents on flavors of coffees and specific products they sell. Starbucks has plenty of marketing campaigns that they could possibly license or protect, in order to keep themselves unique. Brand name is a large factor in a merchandising industry, so the logo and name itself are very valuable intangible assets for Starbucks.

iv) There was a large increase (23%) in total liabilities and long-term debt more than doubled, which means they financed many of their activities through debt, probably bonds, and debt is non-owner financing. Starbucks generally has a lot of cash on hand due to the nature of their business and they can finance through cash; however, large projects are normally done through debt even with a lot of cash, so that interest payments are not of concern. In the chart below, one can clearly identify the large amount of long-term debt, and the amount it has increased. Equity is not a large part of Starbucks financing methods.

Current liabilities:				
Accounts payable	491.7	398.1	4%	5%
Accrued litigation charge	2,784.10	0	24%	0%
Accrued liabilities	1,269.30	1,133.80	11%	14%
Insurance reserves	178.5	167.7	2%	2%
Deferred revenue	653.7	510.2	6%	6%
Total current liabilities	5,377.30	2,209.80	47%	27%
Long-term debt	1,299.40	549.6	11%	7%
Other long-term liabilities	357.7	345.3	3%	4%
Total liabilities	7,034.40	3,104.70	61%	38%
Shareholders' equity:				
Common stock ($0.001 par value) - authorized, 1,200.0 shares; issued and outstanding, 753.2 and 749.3 shares (includes 3.4 common stock units), respectively	0.8	0.7	0%	0%
Additional paid-in capital	282.1	39.4	2%	0%
Retained earnings	4,130.30	5,046.20	36%	61%
Accumulated other comprehensive income	67	22.7	1%	0%
Total shareholders' equity	4,480.20	5,109	39%	62%
Noncontrolling interests	2.1	5.5	0%	0%
Total equity	4,482.30	5,114.50	39%	62%
TOTAL LIABILITIES AND EQUITY	$11,516.70	$8,219.20	100%	100%

Figure 7.5

H

i) Starbucks operates under a cash basis. They recognize revenue at the point of the sale to the customer. Starbucks revenue comes from licensed locations, wholly-owned subsidiaries, sale of coffee and food in normal operations, and store gift cards. For licensed locations revenues include royalty fees. Wholly-owned subsidiaries are consolidated into the consolidated financial statements. Normal store operating revenues are recognized at the point of the sale. The most interesting and different revenue recognition Starbucks must maintain is for the store gift cards. Revenue is recognized when cards are used, going from deferred revenue to service revenue. However, management must decide how much of the current non-redeemed cards are expected to produce revenue. Management will recognize a percent of deferred revenue as revenue, based on past estimates and future predictions.

ii) After creating the common-sized balance sheet, it is easy to identify which expenses are larger than others. In general, beyond the costs of sales, the largest expense to Starbucks are store operating expenses. This makes sense to an analyst because brick and mortar stores require a lot of overhead, labor, and distribution. Starbucks has many locations, this making the volume of this expense very large. In 2013, a large expense came from the results of a litigation. This is not a normal occurrence and is not normally budgeted for. It is also not common for this expense to be within the operating section of the income statement.

iii) From 2012 to 2013, there were a few significant changes in revenues and expenses. Revenues increased by roughly 12 percent, store operating expenses increased by 9.4 percent, General and administrative expenses rose by 17 percent, and depreciation increases by just over 12 percent. These increases are large without context, but it makes sense when one understands the amount of growth Starbucks has experienced over this year, from acquisitions to higher sales/operating volume.

iv) Since the lawsuit is stemming from normal operations, the expense coming from the lawsuit could be placed as an operating expense. Also, some corporations would love to recognize a gain from litigation as part of income to improve their bottom line, if in the past Starbucks has recognized a gain from litigation as part of the income statement, a loss from litigation needs to be treated the same way. It is important that accounting procedures are consistent, which makes them more reliable. If the rules for a football game were to change every year, people watching (investors) would become confused, and previous games (reports) would become invalid due to the change.

v)

Consolidated Statements Of Earnings (USD $) In Millions, except Per Share data, unless otherwise specified	1: Sep. 29, 2013
Net revenues:	
Company-operated stores	$11,793.20
Licensed stores	1,360.50
CPG, foodservice and other	1,738.50
Total net revenues	14,892.20
Cost of sales including occupancy costs	6,382.30
Store operating expenses	4,286.10
Other operating expenses	457.2
Depreciation and amortization expenses	621.4
General and administrative expenses	937.9
Litigation charge	2,784.10
Total operating expenses	15,469
Gain on sale of properties	0
Income from equity investees	251.4
Operating income	-325.4
Interest income and other, net	123.6
Interest expense	-28.1
Earnings before income taxes	-229.9
Income taxes	-238.7
Net earnings including noncontrolling interests	8.8
Net earnings attributable to noncontrolling interest	0.5
Net earnings attributable to Starbucks	$8.30
Earnings per share - basic	$0.01
Earnings per share - diluted	$0.01
Weighted average shares outstanding:	
Basic	749.3
Diluted	762.3
Cash dividends declared per share	$0.89

Figure 7.6

In the technical sense, Starbucks did not have a Net loss. From this logic, I would say Starbucks was profitable. Personally, and based on previous years Starbucks was not as profitable and was very close to being under the break-even point. Luckily, interest income and other earnings from non-controlling interest prevented them from reporting a net loss.

I

i) Starbucks has grown tremendously with a lot of investing into new stores and locations. The result of these investments has allowed Starbucks to increase overall sales volume and cash generation based on sheer Economies of scale. There is more contract power and Starbucks collect cash well and easily based on the type of business they are. Revenues did not grow as much in the same year as cash flows from operations grew. Revenue slow growth comes from other things such as throwing litigation expenses into net income. The Depreciation/Amortization expense along with litigation expense was the culprit of the slow revenue growth.

ii) In 2013, 1.151 billion dollars was investing in property, plant, and equipment. This is a 295 million dollar increase from the previous year. Again, this makes sense to an analyst due to how much Starbucks has been growing in the recent years through acquisition and organic growth. Investments into the fixed assets of the firm is necessary to keep up with the new increases in activity.

iii) The comprehensive statement of equity states cash dividends of 668 million. The Statement of cash flows shows 628.9 million cash dividends paid. The statement of cash flows shows the exact amount of cash leaving the firm. The difference between dividends declared and dividends paid would go to accrued dividends for the next dividend payment date. If there are preferred stockholders that are comprehensive and participating, the accrued dividends with go to those holders first, before common stockholders.

J

Unearned Revenue and Revenue in general are affected by the estimation of revenue coming from unredeemed store value cards (gift cards). This is unique to Starbucks and other retailers that have gift cards as a common part of their business. This estimation is very similar to the way Accounts receivable and bad debts are estimated. The firm estimates how much money they expect to receive from gift cards previously bought. For many reasons, gift cards are not redeemed. Sometimes they are given as gifts to individuals who do not have a desire to use them, they expire after a certain period, and sometimes they are simply lost. Another estimation that is common throughout most businesses is PPE, due to the estimation of depreciation of the PPE. Accounts receivable is estimated. The firm estimates how many outstanding receivables it will actually receive. For a business in which inventory is perishable, inventory obsolescence is an estimation Starbucks must acknowledge that other industries do not. Goodwill and other intangible assets are estimated. In 2013, Starbucks increased Goodwill due to an acquisition, so Goodwill estimations were used in this process. Accounts that are estimate free would be most of the expense accounts, accounts payable, and most liabilities. One does not estimate bad debts of themselves and expect not to pay certain bills. Expenses are set in stone, if a certain amount of supplies are bought, the price does not alter. The amount of money in retained earnings is not estimated, it is a confirmed amount based on net income entering and dividends leaving.

<u>Case Study 8: BP</u>

Introduction:

Personally, I knew a decent amount about the BP Deep Water Horizon Oil spill, due to my hometown's proximity to the Gulf Coast. I have family that lives there, and have spent a lot of time there visiting and on vacation. The Mississippi Gulf Coast is a very populated area and brings in a lot of revenue to the State, due to all of its manufacturing and transportation industry. My Grandfather also worked oversees on the corporate level with BP for many years, but retired many years before the oil spill occurred. I witnessed firsthand how the gulf was affected. The water was ruined for many months, wildlife was killed, and tourism declined. Mississippi took a large hit from this very popular part of the state, and it also recovered very slow. Still today, people mention the spill in a grave tone, remembering the hard times their families and businesses experienced. However, until now I did not realize how much of a financial impact the oil spill creates. I also did not realize the accounting procedures necessary for this type of situation. For one, most Mississippians and Gulf Coast residents had a very sour view of BP after the spill, and did not care how they fared. BP was put into a very difficult position due to this large accident. I did not realize how many lawsuits BP was exposed to, and how many were not directly tied to the spill, but were attempting to squeeze more money out of BP, because they could. After doing research through this case, I now know how difficult accounting procedures can be and how important estimations are. Estimations are presented on financial statements, so it is imperative that the estimates are accurate and reliable.

A

A contingent liability is a liability that could occur in the future, but at this time it is uncertain that the liability will occur or not. The outcome is contingent on future events that are yet to occur. The amount of the potential liability can be recorded, if the amount can be reasonably estimated and the occurrence is probable. A company would record this liability, or possibly in the footnotes if the occurrence is probable to happen, by using the most likely method, and the amount of the liability can be reasonably estimated. Lawsuits are common contingent liabilities, lawsuits are known or presented far before the verdict is reached. Product recalls could also be a contingent liability, because it could be known that there is a default in the product, but the quantity of products to be returned is unknown. Contingent gains are not as common, and less commonly reported on any financial documentation, if at all. Conservative reporting would guide entities to not record a possible increase in assets or revenues, until they actually occur. A very common example of a contingent gain would be the successful outcome of a lawsuit.

B

The product warranty for a seller of an item, such as GE in this scenario, is a liability that will adjust into an expense over time. There are sometimes assurance warranties, sold wrapped into the sales price of the product. Then there are extended warranties that last commonly over one year. The seller must be cautious that a return on the product is possible, and account for that possibility. GE must set aside funds to use in case the product is returned. For the purchaser, such as BP in this case, uses the warranty to their advantage. This is not an asset for BP recorded separately. This idea also falls under the principal that contingent gains are not recorded. To replace an asset would not be a gain for BP, but generally potential benefits are not recorded in financial statements. The value of the product warranty and the amount of extra dollars BP spends on it, should be included in the total value of the asset on the balance sheet.

C

It is very important for management to accurately estimate a contingent liability and also product warranty costs/liabilities. These two things can have substantial impacts on financial information presented to the public if they are exercised. It speaks to the quality of products and services provided. No investor or creditor enjoys seeing a lot of lawsuits or product returns against a company they would like to invest in. This would deter investments due to increased uncertainty and irregularities. Secondly, if the return or lawsuit is unavoidable, it is important for management to accurately estimate how much it will be, to reflect the most accurate numbers possible. If these numbers are not estimated correctly, this also gives investors and other external parties less confidence in the company's ability to perform, and possibly give off the effect they are not being truthful about the negative things happening to them. For BP, recording a contingent liability in the case of the oil spill was incredibly difficult. It was mainly difficult due to how many people and different industries were affected by one accident. In a separate situation, where one individual slip and falls inside of a McDonald's, it is easier to estimate the amount of liability needed to be recorded, because one person was affected by it. With the oil spill, many people and businesses were affected. Many lawsuits were made against BP in this oil spill situation. It is important to understand that the 2008 financial crisis took place very recently before this oil spill, and many businesses around the nation and in the Gulf, Coast were hurting. Some lawsuits were extremely valid, such as fishing charters whose waters were unusable due to the oil, and commercial fishermen who catch large amounts of their inventory in now contaminated waters. These two cases are extremely valid because they were directly affected, and it can be directly traced. Even industries like tourism on the coast such as parasailing businesses or beach front hotels and restaurants could directly site the oil spill as the reason for losing business, etc. Now once the lawsuits begin to get into a grey area. A real estate broker in the Gulf Coast may sue BP, due to declining deal closings and less demand for wanting to purchase property on or near the beach; however, this could also be due to the housing market bubble collapse in 2008, which would more directly affect the real estate market, especially second homes on the coast. Some businesses and restaurants filed lawsuits for declining customers, but rather than the oil in the water being the reason, it could more likely be due to household's financial well-being and propensity to consume declining due to the markets crash a few years before. I believe that there are multiple lawsuits that BP should not create as a liability, because BP could be sued, not the NYSE.

Product warranties are different from contingent liabilities, because they can be more reasonably estimated. There may be historical information on warranty expenses, and it can be forecasted more accurately how much will occur in the future. Also, a company knows exactly how many items it sold, so it knows the amount on warranty on each product cannot be more than what they sold. In a situation where, the product could be the cause of other companies' lawsuits, it needs to be analyzed further. If the warranty were to cover the replacement costs of the product and the damages done, then the seller of the defective part could be ultimately responsible for all lawsuits. In a situation where the extent of the damages is not their liability, the seller of the part does not have as large or a liability to record.

D

Some of the expenses BP incurred were not necessary to estimate, because they may have been outlined or known before the spill occurred. For example, fines from environmental agencies or regulatory agencies may be standard for certain situations. However, some of the fines may have been dependent on severity of the spill and damage. Other estimates, which are listed in point C of this case, were very hard to trace due to the reasonableness. BP had to analyze each lawsuit to determine if they believed it would hold up in court, or be invalid due to other reasons, such as the financial markets crisis. Due to multiple parties being involved in this situation, such as Transocean and Halliburton (owners and operators of BP's rigs), it can be unclear how much responsibility should be allocated to each of these entities, especially in times leading up to prosecution while estimations of liabilities are most necessary. The Justice department is able to sue all entities involved for violations of various environmental acts such as the Clean Water act of 1948 and the Oil Pollution act of 1973. Litigation between the Federal government, environmental groups, and individuals versus large corporations (public and private) creates a very elaborate and time-consuming process that takes many years and many crucial estimations.

The Exxon Valdez oil spill took place in the late 1980's and was not officially resolved until 2011. The BP oil spill still had active litigation going on until the summer of 2017. There are still effects and controversy over the BP oil spill today, questioning if it is really over. Oil spills like this are so damaging to many different entities, and it is very hard to sort out direct relations between things. To be safe and to report conservatively, entities like BP and Exxon must over apply contingent liabilities. Underestimating and underapplying can turn out more detrimental, especially when the actual results are higher. Money must be pulled from other sources, which can be harmful to the firms' stability and create other problems that would need to be patched later on.

Case Study 9: Wendy's

Introduction:

Before this case, I had no prior knowledge of Wendy's investment into Tim Horton. I had no prior knowledge of Tim Horton due to their geographic location. However, I am familiar with the Equity method of accounting for investments, due to intermediate accounting. Our recent studies and testing of the investments portion of the balance sheet allowed me to be relatively comfortable when reading about equity investments, significant influence, and related accounting procedures. I understand that joint ventures are a very popular mode of investing, because it reduces risk exposure on one entity by splitting it between two or multiple. Also, there can be more funds in the deal when multiple entities both pitch in financially. Joint ventures are a safe and viable way for companies to diversify their portfolios, by both contributing knowledge, expertise, and resources. I was not familiar with the idea of renaming the joint venture, like how Tim Wen is created in this case. Each of the requirements of this case helped me learn more about accounting for an equity investment using the equity method. Each requirement also helped me understand how and why a premium is paid for an investment, and where those excess dollars actually go. There are many reasons to pay an excess amount over the book value, but I did not know that part of that amount went to marking the net assets up to fair value. It makes a lot of sense why this would happen. It increases the value of the assets invested in, so that the price paid matches what is truly there. It also is logical that this amount is not amortized as part of the tangible assets it increases, because the asset did not truly gain that value or add it to the book value. The amortization is shown separately on the investor's books. This case has given me a lot of insight on the procedures of equity investment accounting.

A

In general, companies enter into joint ventures to pool together for a common goal. The common goal is to usually achieve a high return on an investment or either reach a customer base not possible when alone. The proceeds of a joint venture agreement are split amongst investors based on investment percentages. Mainly, one will reach out to another company for a joint venture when they lack something necessary to do it by themselves, such as funds or knowledge. Another positive part of joint ventures is reducing investment risk, because all uncertainty is not placed on just one investor, only the portion they invested. However, with lower risk there is lower reward, meaning if there is a high return or good outcome, the investor only gets the percent they invested originally. There is a desired level of flexibility found in joint ventures that cannot be found in other investment vehicles. There are less legal requirements keeping one locked into a specific deal, and responsibilities are split amongst partners of the deal. Whenever one entity has the capital and another has the market expertise, that can be a great potential for a joint venture for both entities.

B

The way equity investments are accounted for on the investors books all depend on the ownership percentage, and the amount of influence or control the investor gains from it. There is the fair value method, for smaller percentage investments and when there is no significant influence obtained by the investor. The more common method, and the one used in this case is the equity method. This method is used for most investments up to 50 percent or where significant influence of the investee can be established. Fifty percent ownership could even call for controlling interest and create a subsidiary relationship, but it does not in this case. The equity method starts by reducing cash and increasing an investment account upon acquisition. Any time there is a net income by the investee, the investment account increases with a debit and investment income increases with a credit. If there is a net loss, the opposite occurs and the entry flips. The amount increased or decreased is the amount of net income or loss times the ownership percent. If the company loses half a million dollars, the investor doesn't lose that much money, only the 50 Percent of the half a million, the portion it invested into it. Dividends on the other hand increase cash but reduce the investment account, by the same ownership percentage. This investment account is reduced because the investee loses capital here, but at the same time gives some of it to the investor at the same time.

C

Wendy's purchases Tim Horton's, asserting significant influence with a 50/50 venture, but does not have controlling interest. With this large on an investment, it will be accounted for using the Equity method. Generally, whenever one entity acquires another, they will pay a price greater than the book value of the target (assets-liabilities). This excess purchase price is recorded as Goodwill, and account created in times of acquisition. In this scenario, the excess in purchase price is AAP, which is split into two different things. Half of the AAP goes to the book value of the net assets and marks them up to fair value. The remaining half goes to Goodwill. The portion that increases assets to FV is not depreciated by Tim Horton as part of the assets it increased, instead Wendy's, the investor has an annual depreciation expense on the amount dedicated to increasing the assets. The amount used to increase the assets to fair value are not on Tim Hortons books. All of these numbers are expressed in ownership percentage, which is 50 percent.

D

In reference to Note 8 of the financial statements, the equity investment portion is shown from years 2011 and 2012. All of the equity investments Wendy's has, are listed. For the THI investment, 2011 shows a balance of $91.742 million, but a 2012 balance of $89.370 million. Investment accounts decrease in value from net losses and from dividend payments. The equity investment account decreases by the 50 percent ownership portion of the loss or dividend payment. This investment can be found on Wendy's consolidated balance sheet, in the investments sub section. It is a long-term investment and not a consolidated subsidiary. Since this is not a controlling interest of 5 percent or lower, it is only significant influence. If there was controlling interest or if Wendy's had purchased more than 50 percent of TH, the financial statements would be consolidated and there would be a parent-sub relationship. Essentially, this is just a very large long-term investment and it should be recorded as such.

E

As seen from Note 8, the balance of the 2012 equity investment account is 89,370. Now, if one looks at the 'partners equity' (Net assets) on Tim Wen's information page, p.79, the balance is 70,565. By taking 50 percent of this number ($35,283) as Wendy's contribution, that will represent the accounting acquisition premium (AAP). This premium includes the markup to fair value and Goodwill. This excess amount is constituted by giving incentive and paying for the true market value. Yes, the book value of the net assets is lower than what they paid, but part of the price went to increasing the assets value. This shows the true value of what is paid for. Also, there are intangible things that cannot be accounted for on the balance sheet that make Tim

Horton more valuable, like the essence of their existence, and strong customer concentrations and loyalty. This excess amount incentivizes the investee to accept the deal, and there are also brokerage fees that must be accounted for in an investment of this caliber.

<u>F</u>

i. Wendy's income before taxes is affected by the equity method because the proceeds from it are placed into other operating expenses, net. This in effect, increases the amount of income before tax. If this was accounted for in a different way, maybe besides the equity method, income before taxes could potentially be different from what it is now.

ii. Journal entry for Wendy's share of Tim Wen's 2012 earnings:

Equity Investment 13,680

Equity Income 13,680

This represents an increase in the investment account and an increase in investment income, by the ownership percentage of 50 percent.

iii. The acquisition premium price is paid in excess and is amortized on the investor's books, rather than part of the assets on TH books, because they are not truly there. This amortization is over the useful life of 21 years. Using straight line depreciation, we divide the excess premium by the useful life to arrive at 3,129. The journal entry is as follows:

Investment Income 3,129

Equity Investment 3,129

iv. The number of dividends received from Tim Wen in 2018 is 15,274, which can be taken from Note 8. This amount is already 50 percent of the total, which is the same amount that was added back to the statement of cash flows. Cash is received but the same amount decreases the equity investment account. The journal entry is as follows:

Cash 15,274

Equity Investment 15,274

G

i. The statement of cash flows works under a cash basis, where inflows and outflows are recorded to adjust the operating, investing, and financing spaces of a company. Tim Wen is accounted for under the equity method, meaning net income or net loss of TH increases or decreases the equity investment account along with an investment income account. Cash or revenue is not given to Wendy's whenever there is net income, thus there is no cash inflow. Starting with Net Income, equity income of 8,724 in 2012 should be deducted. Negative adjustments adjust net income toward the correct amount of cash from operations.

ii. Under the equity method of accounting for an equity investment, there is an increase of the equity investment account and an increase in cash whenever dividends are received. This is a direct inflow of cash to Wendy's from their investment in Tim Wen. Positive adjustments to net income come from dividends, because it originally is not included, but must be included later in this statement to accurately reflect the amount of cash from operating activities. These portions that are adjusted to net income are in ownership percentage, which is 50 percent.

Case Study 10: Johnson & Johnson

Introduction:

Coincidentally, while completing this case study, I was simultaneously studying the accounting of pensions during my intermediate accounting class on campus. I was fortunate to have been taught this material in two classes, and was able to put my knowledge to use on this case. The main difference between the Johnson & Johnson case and other examples used in class, besides it being real and not a fictional example, were the information given and not given. During classes, most materials are given to us that are important, and we are tasked with completing a calculation or recording a journal entry. In this case study, we needed to sift through financial statements and disclosures in notes in order to find our material information. It is a great learning experience to search financial statements, read line items, and practice interpreting them on our own. Pension liabilities are a major item on the balance sheet and create many expenses each year. One may not originally think of pension obligations being an incredibly important aspect of an economic entity, because it is not essential to ongoing operations, but clearly the amounts are very material and substantial. Having a funded pension obligation is extremely important to a company and the participants. It is a benefit that employees receive more than just their annual compensation, increasing demand for providing services to the company.

A

Flow chart for pension obligation:

Figure 10.1

i. The largest difference between defined benefit and contribution plans are the entities that are involved with contribution to the plan. Defined contribution plans allow the benefit recipient to contribute to the plan, and the sponsor will match the contributions. Defined benefit plans guarantee an amount to the employee based off of years of service, salary, and other criterion. Stated within the information given, specifically in note 13, Johnson & Johnson have many different pension plan sponsorships, including defined benefit plans, defined contribution plans, and indemnity plans. These are the main three that cover all of their employees. We are also told in this note, that there are some postretirement plans involved with providing health care to retired employees.

ii. Retirement plan obligations are liabilities because the sponsor of the plan, are obligated (or liable) to pay an amount in the future, for services provided to them as an employee. Commonly, the plan is underfunded creating a pension liability, where the plan assets are less than the benefit obligation. As a bottom line, the pension obligation is an amount due to someone else, where interest and principal are accrued over time.

iii. The assumptions made by the actuary are incredibly important when computing the pension obligation. Important assumptions would include the employee's retirement age, mortality rate, and salaries while in service. Other important assumptions would be the interest rate on the liability, or the expected return on the plan assets. All of these assumptions could alter the calculation of the pension obligation, which alters the balance sheet and other financial statements, which are seen by investors and creditors. Besides the financial reporting aspect, it is important to completely fund the pension obligation so that its dedicated employees will be benefitted during retirement. A company can get a bad reputation, or dissatisfy its employees if they are not fulfilling their obligations. That is one reason defined contribution plans are the most popular plan in recent history, it allows for fewer underfunded situation.

B

Service costs arise as an expense to the sponsor of a pension plan for another year of service completed by its employees, the pension plan beneficiaries. Interests costs result from the benefit obligation, due to it being a deferred liability, similar to a notes payable. Actuaries determine amounts owed by the sponsor based on many criteria, and whenever an employee retires or ends services to the sponsor earlier than predicted, that may result in a gain to the sponsor. If the employee stays in service longer than expected, there may be more money owed to them than previously estimated, resulting in a loss, or excess due than budgeted for. Benefits paid to retirees are the payments realized after years of service, it is the payment made from the plan assets to the employee. This is the ultimate goal of a pension obligation, accumulating enough benefits to then give to employees as compensation.

C

Of the three large influences on pension assets, actual return on pension investments are the most out of the sponsors control. The amount placed into plan/pension assets is grown in the market as an investment. The amount of return on their investment is unknown, and must be estimated at the beginning, then compared to actual return at the end, creating a gain or loss. It is ideal to conservatively estimate the return, and hopefully end up with a higher return and unexpected gain. The next influence would be contribution by the sponsoring entity. Contribution are payments made to the pension plan investment in order for it to grow. Benefits paid are the amounts taken out of the accumulation of funds invested and grown over time, to the benefitted employees.

D

The return on plan assets for pension plan assets is the amount of return the investment makes in the market. The pension plan is invested with the intention to grow, this grown amount plus contributions made is the amount that is available to be given to retired employees as benefits. If there is a recession or downturn in the market, there could possibly be a negative return. The return used in calculating pension expense is different, if the actual return is greater than expected return, that eases the burden or the actual expense the sponsor takes when calculating its pension expense. If there is a large return on the invested plan, that is less money that needs to be given up, because the market has made it for them. If the actual return is less than expected in this case, more money or a higher expense would be necessary to cover the amount due to the obligation.

E

Taken from the notes to the financial statements, the insurance and health care benefits are different from the retirement plans, primarily due to how they are structured and funded. The health care plans are not funded in advance like the pension obligation. Also, the terms of the health care plans can be modified at any time, where defined benefit plans, or contribution plans are not modifiable, and are based off multiple criterion such as compensation levels and years of service. The health care benefits are also granted to benefit the dependents or the retired employee, creating another difference in the two structures. Retirement plans, since they are future obligations of payment in the future, are always classified as liabilities.

F

i. The amount reported as pension expense (net periodic benefit cost) in 2007, was $646 million dollars.

ii. Service costs and interest costs are the main components of the annual pension expense. The interest cost comes from the interest accumulated from the outstanding liability, and service costs come from an additional year of employees' service. The amounts for these two costs can be found on page 61, in the year 2007.

The entry is as follows:

Pension Expense 1,253,000,000

Projected Benefit Obligation Service Cost 597,000,000

Projected Benefit Obligation Interest Cost 656,000,000

<u>G</u>

iii. The value of the projected benefit obligation at the end of 2007 is 12 billion dollars. This is the balance after all the changes during the year, from things like service costs, interest expense, and returns. This amount represents the amount estimated to be due to employees in the future. The number is reliable as it possibly could be, considering its estimation heavy nature. There is a lot of estimation involved in calculating this value, making a large possibility that this number will change over time, or fail to be funded fully. Overall, the number is reliable as possible, but the accuracy is questionable.

iv. The interest cost on the pension obligation for 2007 is $656 million dollars. The interest rate or settlement rate on the obligation must have been 5.6 percent, in order to yield this much interest on the beginning balance of the obligation. This rate may be reasonable if it is comparable to other rates found in the market. This rate is not extremely high or low, making it a standardly reasonable interest rate. The rate for a large company may be lower, because there is less risk on defaulting on its obligation.

v. The amount paid to employees during 2007 are $481 million dollars. This comes from benefits paid from plan assets, the normal account where actual benefits are taken from and given to individuals. This amount is not paid in cash, it is paid by amounts already contributed to the plan assets and grown in the market. Paying benefits to employees decreases both the pension obligation and plan asset accounts. Pension obligation is decreased because there is less obligated to pay employees because it has been partly satisfied. The plan asset account is decreased because the $481 million came from this account.

H

i. On December 31, 2007 the plan assets value is $10,469 million dollars. This amount is stated at fair value. This is the accumulation on contributions made by the plan sponsor and the amount of return it has made in the market.

ii. The expected return on plan assets for 2006 and 2007 were $701, and $809 million respectively. This amount is taken from the net periodic benefit cost chart found on page 61. The actual return, found on the change in plan assets section of page 62, for 2006 and 2007 was $996 and $743 million respectively. There is a large difference in amounts in 2006, which indicates the expectations were not as accurate. Fortunately, the actual amount in 2006 was a lot higher than expected, creating an unexpected gain and potentially getting closer to a plan asset (excess over liabilities). However, 2007 expected return was higher than the actual return, resulting in a loss. In order to make up for this amount not added to the pension plan, the sponsor must contribute more or either undertake a larger obligation to pay later (remain underfunded).

iii. In 2007, the amount contributed by the company, the sponsor, was $317 million. The contributions by the participants was $62 million. The sponsor contributes a lot more than the employee participants. In 2006, the contributions by the company was $259 million and $47 million by the employee participants. This is less than 2007, but the ratio from participants to company contributions are essentially the same at roughly 84% of total contributions coming from the company and the remainder coming from the participants.

iv. From page 63 of the financials given, the retirement plans are broken into equity, debt, and other investments. Of the US retirement plans in 2007, 79% were equity investments and 21% were debt investments. For the international retirement plans, 67% are equity, 37% are debt, and 1% were real estate and other investments.

<u>I</u>

At the end of 2007, the plan is underfunded by $1,533 million dollars this can be found at the end of the 'Change in Plan Assets' section. The line item is called "funded status at end of year". At the end of 2006, the plan was underfunded by $2,122 million. This means the company funded the plan by $589 million over a one-year span.

Case Study 11: "On the Balance Sheet-Based Model of Financial Reporting"

Introduction:

Before reading this research article, I had no prior knowledge of the origins of financial reporting and what went into deciding much of the accounting principles. I did not previously know there had been any different way to report a company's financials, and did not know that there has been recent backlash on the current method and priorities. As I will mention in the case, my little knowledge of standard and policy setting bodies in accounting has always seemed so stagnant and never-changing, especially as a student. In a sense, for public accountants, the rules are never-changing, as we must follow the laws in place to govern our decisions. For other finance and consulting professions, the financial statements can be taken and interpreted in multiple ways. As I read this document, I easily agreed with the authors statements on a faulty balance sheet approach and an income statement approach filled with more useful and business-oriented information and fact patterns. The income statement approach is not the cure-all or the absolutely correct method, but it is more correct. It is mentioned to be more corrected by the author because of its earnings focus and revenue/expense matching and recognition. These things that the incomes statement does best is one of the most important things accounting solves, making sense that we as an accounting industry should realize and focus on more heavily. I was extremely interested in what the article had to say, because I could visualize so many companies that this model applied to. There are many service industries where assets are so little that they are almost immaterial. It is not fair to base all of their value off of their balance sheet, or to prioritize that approach over another. After completely finishing the reading, I believe that companies should have the choice in which method they present their financial statements. This does not satisfy the consistency principal, and makes this unclear from company to company, but no company is alike and that is an issue we must understand and accept in the first place. I believe financial statements' purpose is to accurate reflect the operations and health of a company rather than throw it into a cookie-cutter approach and force them to adapt. Overall, I really enjoyed this case's material because it gave me a new view on accounting principles and how I view business and economics.

Columbia Business Schools article, "On the Balance Sheet-Based Model of Financial Reporting", opens by stating the origins of balance sheet reporting. In the 1970's the Financial Accounting Standards Board (FASB) labeled balance sheet accounting as the cornerstone of financial accounting and reporting. This was justified by saying earnings are a "change in value", but balance sheet items are the valuable items in which earnings are derived. This gave priority over focusing on strictly earnings. The balance sheet approach is deeply rooted in codification and principal both domestically and abroad, making it difficult to divert from. However, the introduction to the article explains again why it is believed to be flawed, and provides a vision to what could be improved by altering or implementing a new mode of financial reporting. The article points out that earnings and profit maximization are more of a firm's goals and it should be seen as more important than balance sheet items, when valuing a firm. The income statement provides these trends and numbers in regards to earnings, and disregarding the income statement approach could lead to faulty accounting. However, the income statement relies on proper balance sheet valuation and estimation methods in order to be correct. This is a very crucial correlation.

One important point given to the income statement approach, is the principal of revenue and expense recognition, and the proper accounting of accruals, which is one of the main purposes of accounting. Investors and creditors, the primary users of financial documents are more heavily focused on potential earnings and their status. The article's body contains mainly criticisms of balance sheet accounting and cites many different, well-developed reasons. Firms are not “asset greenhouses” where money is earned from their existence. Firms are asset sacrifices, and only own them to earn revenue, then replaced. Another reason for flaw is embedded within FASB’s own definition of an asset, a balance sheet item. It is stated that an asset is prioritized first, because it needs to be defined first. However, in the definition of an asset, they are classified as probable future economic benefits. Another common term for this would be earnings. The FASB attempts to separate assets and liabilities from income statement items, but they are interconnected.

In regards to the investment community, the income statements priority of earnings is the most important statement to analyze. Earnings show growth, growth in stock price, and dividends. These are all incredibly important when determining investment strategy. The balance sheet approach is also faulty because balance sheet items require a lot of estimates, and they are hard to apply. A lot of numbers are different, based off different accounting approaches, which makes the income statement alter with it as well. If the income statement approach was prioritized, it would not rely on a faulty balance sheet to be accurate.

To summarize the solutions presented in the article, the main point is to have a clear distinction between operating and financing activities. The article does not state that the income statement approach is the hallowed solution. There are mentions of improvements that the income statement approach needs to improve, such as steering away from a single bottom line. At the same time, the income statement approach includes more methods and principals that are seen as more important. These ideas are expense and revenue matching and recognition. Essentially, the financial reporting method should represent the core values of this ever-evolving business environment, rather stuck in its old ways.

How did this article change your current way of thinking?

Personally, before reading this article, I have always been more inclined to view accounting and the production of financial statements from the investor's point of view. I have always used income statement numbers to form many opinions on a company's well-being and earnings forecast, especially in the short term. Projected EPS, reduction of operating expenses, and creation of new revenue streams are all components of growth and stock price increments. For short- and long-term stock holdings, high earnings also give reason for dividend disbursement and increases. For large and long-term investments such as mergers and acquisitions, purchasing entities may focus on the balance sheet more. Ratios such as asset, inventory, and accounts receivable turnover are important to analyze. Determining how operations are financed are also found on the balance sheet. With all of this being said, a strategic move such as a merger is still an investment that requires a return. A return on investment would be an increase in the parent's income from consolidated statements, AKA high earnings from the subsidiary or new business component. The income statement and its focus of principals would provide the most useful information in determining a return on investment.

By previously having a thought process similar to this article, I was comfortable reading and agreeing with what the article was presenting. I had previously thought the same way, but did not have a plethora of evidence on why, and this case has supplied me with reasons to continue supporting my mindset. Especially recently, a lot of firms have come about in order to service their clients and customers with very little assets and capital expenditures needed. Entities like Uber, Airbnb, Ticketmaster, and others make money over the internet with very little assets. Uber does not own any of their vehicles, Airbnb does not own any properties, and Ticketmaster does not have much physical infrastructure. These services link one customer with a demand, with another individual who owns the actual asset of interest. There are no, or very little money-making assets on any of these companies' balance sheets.

Another thought process I have gained from this case was how fluid accounting principles and standards can be. Certain entities' adoptions of principals due to convenience and ease over practicality are astonishing. FASB attempting to merge common thought of accounting rules with international regulators are in order to satisfy uniformity and consistency, not because it proves to be the most accurate method. As a student, I have always viewed GAAP and FASB and other codes and regulators to be stagnant and never having the ability to alter. I have now come to the realization that there is a push for change in accounting procedures and reporting methods by professionals.

<u>How will you use this information in your future career? Be thoughtful and creative in situations you will encounter where this article with affect your beliefs and ways you carry out your future job.</u>

I will use this information in my future accountant whether or not I remain in public accounting or leave for another field in the business management or finance spaces. I believe this more in a mindset and analyzation tool rather than a practical application. While working in public accounting, I will be limited by accounting regulations and cannot pick and choose how I decide to present financial information. Public accounting firm's procedures, especially in the audit field are strictly limited to a set of guidelines. However, as one's career progresses to become partner, there is an opportunity to give input to regulating bodies on things that can only be known on the job. FASB and other regulatory and policy setting entities must refer to current working professionals to understand what is practical, efficient, and correct to implement.

Specifically, as a CEO of a large publicly traded company. I will use this train of thought more in a technical application, where I will have more authority on how my company's financials are presented. I would focus on earnings in my management techniques, rather than balance sheet values as I understand earnings are more important. Assets are only sacrificed in the sake of higher and more earnings. I believe I would put more time and resources into improving and perfecting numbers that are involved in calculating earnings, rather than balance sheet numbers. I would also understand that my income accuracy is dependent on balance sheet accuracy, and act accordingly. If I were ever in an outside investor firm, as an analyst for Carlyle Group or something similar, I would take this article to heart more dearly and in a more technical and useful sense. As an investor with an accounting background I will have more knowledge about where certain income statement numbers came from and how they were calculated and not waste as much time focusing on the assets of the company. After reading this article I have gained the perspective that companies are more earnings focused especially in modern times and ways of commerce.

If I ever have the opportunity to advise or consult clients through an accounting role, I believe this article will prove to be even relevant. In this specific situation, I will be in more of a role to help clients interpret the financials of another company in a business purchase or combination scenario. People can get lost in the mindset of one company having too much debt or not leveraged enough and it may hurt the return on their investment. In a lot of situation, the capital structure is not the biggest concern. After reading this article I would have plenty of evidence on why I could help the client focus on the earnings rather than the long-term debt the target holds.

I believe there are many applications to this newly acquired mindset. Overall, the most useful and current application is to my mindset of being a student. I now understand that there are differences in accounting procedures for specific reasons. Numbers and presentations can be manipulated and be put into different light in order to show different and more useful trends and data. One report that may not look promising based on the balance sheet may look more promising from the income statement. Numbers can be interpreted differently and more effectively. I personally believe that multiple reports should still be required for public companies. Multiple financial reports show the same entity in different lights, and each report is useful in its own way. Limiting the amount of reports or sticking to one, limits the amount of information that can be harvested from a company. From an accounting standpoint, every data point needs to be accurately reported fairly. From an investing standpoint, I would want all data to be reported so that there is nothing detrimental that may be missed.

Case Study 12: Google

Introduction:

Before undertaking this case, I have always had an interest in the stock market and trading securities. I have a strong interest in economics and how businesses affect the securities market and it affects businesses. From past experiences with a private equity investment firm and the financier's club on the Ole Miss campus, I have come to love business valuation. Identifying trends and finding value in those statistics is very exciting. I love examining macroeconomic occurrences and hearing analysts' views on how it will affect certain markets or individual companies. I think that 'the street' and all of the estimates it creates are exciting, because an estimate or view on a certain company can really affect their stock performance. Before this case, I did not know specifically about Google's earnings in 2013 and the related press release. However, I am familiar with comparing GAAP to non-GAAP numbers from my past experiences. I also have experience valuing tech equities and understanding how important user interactions with advertisements are. The majority of revenues of a firm like Google or Facebook comes from ads and other things like number of unique users and new user clicks. After this case I have learned in more detail how exactly non-GAAP and GAAP numbers are derived from each other. It makes complete sense that non-core business operations or onetime expenses are separated from normal operations in order to keep trends consistent and create the ability to analyze a whole new set of financials. Consistently creating a distinction between the two can create a whole new trend to analyze and that may prove to be important when another restructuring is imminent. Overall, I really enjoyed this case because the stock market and stock charts were involved. It is great to analyze and discuss these things with an accounting mindset.

H

The press release includes information about non-GAAP financial measures for the fourth quarter of 2013. Consider the table that reconciles GAAP measures to the non-GAAP measures. What explains the difference between GAAP net income and the non-GAAP equivalent? Do you agree with each of Google's adjustments in computing non-GAAP earnings? Why or why not?

The comparative table on page 13 shows the reconciliation between GAAP and non-GAAP items such as Income from Operations and Net Income. The furthest left column are the GAAP numbers while the right side is non-GAAP. Between the two columns, there are reconciliations as to why the numbers are different. As one may read, the items that reconcile the two columns are mainly 'Stock-Based Compensation', "Restructuring charges and expenses', and their related income tax effects. As stated in the press release, there is a difference in GAAP and non-GAAP due to expenses that are not reoccurring or regular core operations. It is decided to remove these items and report the two columns separately to accurately reflect the core operations income from the current years, which includes one-time expenses. I agree with Google's decision to do this, because it keeps things consistent and transparent. This aligns past statements that also did not include one-time restricting charges, with this year. This separation also creates another item to compare and analyze as an outside party. Investors can now identify how much income can alter with imminent restructuring to occur, because they have the ability to view past restructuring years.

I

Compare Google's fiscal 2013 earnings performance with the movement in Google's stock price over 2013.

Generally, with the correlation of earnings and stock price, there is a positive relationship. Stock prices change due to reactions to news and data in the market. Whenever an entity reports high earnings, it generally increases stock price because investors love to see high earnings and potential for growth and dividends. However, in some situations where earnings are high, but not as high as the market predicts them to be, the stock price will not increase and may even fall. Through 2013, earnings rose and so did Google's stock price.

Compare Google's 2013 stock price performance with the performance of the broader set of firms trading on the NASDAQ exchange (that is, the NASDAQ index).

The chart depicting Google's stock price and the NASDAQ index is intended to show analyst how a single equity is performing compared to its peers. The NASDAQ index is compiled of thousands of equities, with the majority of them being similar to Google, as tech stocks. Indexes are normally a more smooth and consistent line because it is an average weight of performance, it is less volatile. However, one can see similarities in the two trends, because some sort of new data that affected the heavy tech index, affected Google in the same manner. However, there are no large earnings jumps in the NASDAQ index. Comparatively, Google itself outperformed the NASDAQ over 2013.

Based on the stock market chart, did the market perceive the earnings news in Google's press release dated January 30, 2014, as "good news" or "bad news"? Note: the press release was made available after the close of trading for the day.

After analyzing the stock chart for Google, the market's reaction to Google's press release seemed positive. There is a sharp uptick in stock price starting in February, which is when the market would react to news such as a press release. Press releases are generally not information that the market is informed of beforehand, thus the stock price has not already been adjusted to this news prior to its release. The efficient markets hypothesis states that in an efficient market, which ours is, assets fully reflect all available information. This press release was definitely regarded as "good news" to the investment community. Negative news, even the slightest, can commonly decease stock price in the short run.

J

According to the article, how did Google's fourth quarter revenue and earnings compare to the consensus analyst forecasts at the time of the earnings press release? Are these relations consistent with the positive stock market reaction following the press release?

Google's revenue and income both rose 17% due to high levels of users interacting with advertisement, an enormous revenue stream for tech companies, especially Google. The analysts had projected 16.8 billion in revenue, but actual revenues beat estimates by .1 billion. This gives reason to such a positive reaction to the press release on Google's financial well-being and fiscal end. This large increase overshadowed the shortcoming of EPS. EPS was estimated to be $12.20, but only reached $12.01. This in isolation would have the ability to lower stock price, but as we know things are taken with a grain of salt and in relation to other key statistics and ratios such as revenue growth. This specific year was full of non-reoccurring expenses that investors took into account, and did not weight too much of their decision in those items. These are the same items that generated a lower earnings per share. Google's other revenues doubled over the year to $1.7 billion. This is a very substantial increase which has investors viewing the press release as good news rather than bad. All of this news together makes plenty of sense to why Google's stock price increased.

<u>What other factors does the article discuss that might contribute to the market's positive reaction to the earnings press release? Are there any factors that might cause investors to be concerned about Google's recent performance?</u>

As mentioned in the prior paragraph (item J-i), there were multiple items that intrigued investors. Each of these ratios and trends cannot be taken individually, but as a bundle and weighted appropriately for how important they are. One item that could have deterred investors would be the lower than estimated earnings per share, but luckily it did not. Another item that by itself could be concerning is the 11% decrease in revenues per each user 'click'. This negative stat is also overshadowed by the overall increases in clicks and the market for advertisers paying spending more for online ads growing more than ever before. Facebook, a competitor, saw a substantial increase in earnings and revenues due to ads. These shed promising light for all firms that rely on advertisement revenues, Google included. Investors also love to see a company spending money on themselves to grow and become more profitable. Google has done this by increasing capital expenditures by 125%, a record number for the company. Google's reason for these expenses are to become more efficient and grow their presence. This will increase overall revenues, especially in the long run.

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